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# BOJ June 2016 Tankan Survey

**Large enterprises remain cautious; effects of Brexit not reflected in this survey, further declines likely in the future**

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## Summary

- In the BOJ June Tankan survey of corporate sentiment, the current trend in business sentiment has worsened amongst small enterprises, indicating the difficulty of business conditions. Meanwhile, large enterprises in the manufacturing sector are continuing to mark time at a low level. Large enterprises in the non-manufacturing sector showed worsening business sentiment for the second consecutive quarter, revealing that corporations are cautious regarding the business environment.
- The business conditions DI for large manufacturers was flat at +6%pt in comparison with last survey's +6%pt, while exceeding market consensus at +4%pt. Business conditions DI for large non-manufacturing industries worsened at +19%pt in comparison to the previous survey at +22%pt, but exceeded market consensus at +18%pt. As for the future of business conditions DI, large enterprises in the manufacturing sector are expected to remain flat in comparison to the current survey at +6%pt, while large enterprises in the non-manufacturing sector are seen worsening by -2pt in comparison with the current survey at +17%pt.
- Sales projections of large enterprises (all industries) for FY2016 fell by -0.7% y/y, with recurring profit projections down by -7.3% 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, whose recurring profit projections were revised downwards considerably by over 10% (a revision rate of -11.6%), causing much concern.
- The FY 2016 capex projection for all enterprises in all industries (incl. investment in properties but excl. that in software; all industries, all companies) is +0.4% y/y, an upward revision from the previous report (-4.8%). Due to a statistical quirk, capex projections tend to be revised upwards on the June BOJ Tankan survey, especially in the case of small enterprises. It had been assumed that this upward revision would be smaller than the average year due to stagnant domestic and overseas demand, and the rapidly appreciating yen (the DIR outlook was -1.1% y/y), but in actual fact the upward revision on this survey was almost the same as the average year.

## Large enterprises remain cautious

In the BOJ June Tankan survey of corporate sentiment, the current trend in business sentiment has worsened amongst small enterprises, indicating the difficulty of business conditions. Meanwhile, large enterprises in the manufacturing sector are continuing to mark time at a low level. Large enterprises in the non-manufacturing sector showed worsening business sentiment for the second consecutive quarter, revealing that corporations are cautious regarding the business environment. Sluggish exports and production due to the slowdown in overseas economies are thought to be responsible for weighing down business sentiment amongst large enterprises in the manufacturing sector, as well as the increasing appreciation of the yen since the last survey. As for large enterprises in the non-manufacturing sector, stagnant domestic demand is behind dragging down business sentiment, in addition to the negative effect of rising resource and energy prices for some industries. We consider the Japanese economy to be continuing its economic lull with no clearly driving force, and holding the risk of further declines originating in the economic situation overseas. We believe that the results of the BOJ June Tankan survey are generally in support of our view of the economy.

The results of the current BOJ June Tankan survey do not reflect developments since the decision of the UK to withdraw from the EU, such as the rapid appreciation of the yen and turmoil in the global financial markets leading to falling stock prices and so on. Hence we can assume that more recent corporate business sentiment, especially amongst export driven corporations, is actually much worse than shown in the results of the current survey.

The business conditions DI for large manufacturers was flat at +6%pt in comparison with last survey's +6%pt, while exceeding market consensus at +4%pt. The materials industries improved at +6%pt in comparison to the previous survey's +3%pt. As for performance of individual industries, petroleum & coal products as well as iron & steel improved considerably. The increase in prices of natural resources and energy after the middle of February appears to have worked positively for this industry. As for iron & steel, it is quite likely that positive performance was largely a reaction to the results of the previous survey in which a major decline in business conditions DI was experienced due to the deterioration of the steel materials market caused mainly by excessive supply on the part of Chinese steel manufacturers. Despite the apparent improvement, the business environment for iron & steel remains difficult. On the other hand, business conditions for lumber & wood products, as well as ceramics, stone & clay worsened due to the rising cost of raw materials as well as a reaction to major growth recorded in the previous survey.

The processing industries saw a slight worsening of business sentiment for the fourth consecutive quarter at +6%pt in comparison to the previous survey's +7%pt. As for performance by industry, business conditions worsened for production machinery, business oriented machinery, shipbuilding & heavy machinery, and automobiles. As for production machinery, sluggish capex demand in both the domestic and overseas markets worked in the negative direction. Meanwhile automobiles suffered from the negative influence of yen appreciation and the Kumamoto earthquake, in addition to the effects of halting production of certain models due to the problem of falsification of data on fuel economy on the part of certain auto makers. On the other hand, electrical machinery improved slightly, but business sentiment remains in the negative numbers due to the continuation of difficult conditions. These include rapid appreciation of the yen and the Kumamoto earthquake, in addition to worldwide sluggish demand for smartphones.

Business conditions DI for large non-manufacturing industries worsened at +19%pt in comparison to the previous survey at +22%pt, but exceeded market consensus at +18%pt. At the same time, the business conditions DI of large enterprises in the non-manufacturing sector remains on the high side. Hence there is no need for pessimism, though caution is still required as regards the negative influence of stagnant domestic demand.

Looking at performance by industry, business conditions DI worsened in a broad range of areas. With public investment becoming more sluggish as well as the reaction to the recently quick pace of improvement, construction saw its business conditions DI worsen. Meanwhile, transport & postal activities also worsened along with electric & gas utilities. These industries were effected negatively by the rising cost of fuel after prices of natural resources and energy began to climb again, having hit bottom as of the middle of February. Real estate has peaked out due to weak condominium sales, though the declining trend in the office vacancy rate brought a positive note. As for inbound demand on the part of foreign tourists visiting Japan, per capita expenditure by tourists has declined considerably, leading to a major deterioration of business conditions DI for accommodations, eating & drinking services, retailing, and personal services.

## **Future holds major downside risk**

Looking at the future outlook of business conditions DI, large enterprises in the manufacturing sector are expected to remain flat in comparison to the current survey at +6%pt, while large enterprises in the non-manufacturing sector are seen worsening by -2pt in comparison with the current survey at +17%pt. Corporations will continue to be cautious regarding the future due to fears of worldwide economic slowdown, sluggish exports and production, and weak personal consumption. As mentioned earlier in this report, results of the current BOJ June Tankan survey do not reflect developments since the decision of the UK to withdraw from the EU, but further declines are likely in the future as effects begin to surface.

## **Overseas supply and demand continues to be negative for the manufacturing industry**

Taking a look at supply-demand conditions DI in the areas of domestic products and services for large enterprises, we see that manufacturing saw an increase (improvement) while non-manufacturing was flat. As for manufacturing, a large part of this was the reaction to the worsening of supply-demand conditions recorded on the previous survey, as well the dissatisfying results for supply and demand in contrast to the outlook which called for a deterioration of supply and demand in the future. As for large enterprises in the non-manufacturing industry, weak personal consumption and disappointing domestic capex contributed to negative performance. As for large manufacturers' supply-demand conditions DI for overseas products and services, there was an improvement of -8%pt in comparison to the previous survey (-11%pt), but this factor is still moving in the negative range, and the influence of the overseas economic slowdown is seen as continuing.

## **Major downward revision in FY2016 recurring profits seen for large manufacturers**

Sales projections of large enterprises (all industries) for FY2016 fell by -0.7% y/y, with recurring profit projections down by -7.3% 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, whose recurring profit projections were revised downwards considerably by over 10% (a revision rate of -11.6%), causing much concern. This will likely bring a negative reaction in the financial markets.

The assumed exchange rate in FY2016 for large manufacturers is 111.46 yen to the dollar, a major revision in the direction of a strong yen in comparison to the previous survey's 117.45 yen to the dollar. However, it still pegs the yen at a much weaker point than the actual yen rate seen in recent weeks. There are concerns that unless major fluctuations occur in the exchange rate in the future leading to yen depreciation, earnings of export driven manufacturers will be pushed down further. On the other

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hand, the recurring profit ratio of large enterprises (all industries) have maintained a fairly high level despite the downward revisions.

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

The FY 2016 capex projection for all enterprises in all industries (incl. investment in properties but excl. that in software; all industries, all companies) is +0.4% y/y, an upward revision from the previous report (-4.8%). Due to a statistical quirk, capex projections tend to be revised upwards on the June BOJ Tankan survey, especially in the case of small enterprises. It had been assumed that this upward revision would be smaller than the average year due to stagnant domestic and overseas demand, and the rapidly appreciating yen (the DIR outlook was -1.1% y/y), but in actual fact the upward revision on this survey was almost the same as the average year. The capex projection for large enterprises in all industries was revised upwards to +6.2% y/y, while exceeding market consensus at +5.3%. Looking at large enterprises by industry, we see that the manufacturing industry's capex projections for FY2016 grew by +12.8% y/y, while large enterprises in the non-manufacturing sector were at +2.7% y/y. The pattern of revisions here is around the same as the average year. These results indicate that corporate willingness to carry out capex spending maintains a steady undertone. However, there is a good possibility that the number of corporations putting off capex spending will increase in the future due to the problem of the UK's withdrawal from the EU.

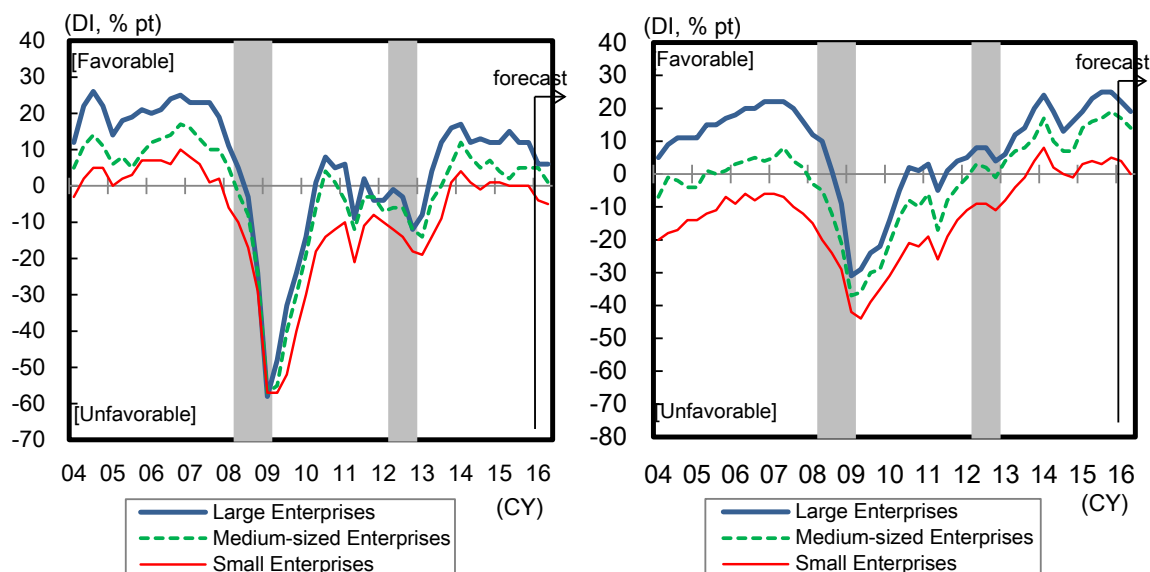
Looking at production capacity DI for large manufacturers, we see that it was at +4%pt, flat in comparison to the previous survey. Meanwhile, large non-manufacturers were at 0%pt, an increase in comparison to the previous survey (this means worsening). These results give us a general sense that production capacity DI is taking a breather in its recent downward tendency. However, both manufacturing and non-manufacturing show a tendency to decline further in the future (meaning an improvement), hence there is no need for excessive worry.

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## **Expectations on the rise regarding major economic measures and additional monetary easing**

The results of this month's BOJ Tankan Survey indicate that corporations are exercising caution regarding the future. Adding the recent UK decision to withdraw from the EU to the mix we see increasing fears of a worldwide economic downturn. If the yen appreciates further against the dollar, going below the 100 yen/dollar point, business sentiment and capex plans of export driven corporations will decline further, bringing the possibility that Japan could return to its former deflationary situation. Meanwhile, the Apr-Jun 2016 period GDP could very well experience negative growth for the first time in two quarters based on the results of weak monthly economic indicators in April and May, and the reactionary decline occurring as a result of the Jan-Mar period leap year effect. With things as they are, hopes will likely be on the rise in the financial markets for major economic measures and some kind of government action to prevent the yen from appreciating further, as well as additional monetary easing measures on the part of the BOJ.

**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					
	March 2016 Survey		June 2016 Survey				March 2016 Survey		June 2016 Survey			
	Actual result	Forecast	Actual result	Changes	Forecast	Changes	Actual result	Forecast	Actual result	Changes	Forecast	Changes
Manufacturing	6	3	6	0	6	0	-4	-6	-5	-1	-7	-2
Textiles	-3	-6	-3	0	-6	-3	-17	-22	-16	1	-17	-1
Lumber & Wood products	41	12	29	-12	18	-11	0	-13	-5	-5	-11	-6
Pulp & Paper	3	7	7	4	11	4	-15	-9	-18	-3	-18	0
Chemicals	10	4	11	1	7	-4	5	-1	9	4	2	-7
Petroleum & Coal products	-16	5	6	22	5	-1	-19	-23	-28	-9	-17	11
Ceramics, Stone & Clay	9	-3	3	-6	12	9	-7	-9	-10	-3	-8	2
Iron & Steel	-22	-21	-12	10	-9	3	-23	-15	-14	9	-16	-2
Nonferrous metals	0	-5	3	3	-6	-9	-8	-9	-7	1	-7	0
Food & Beverages	20	16	29	9	17	-12	6	5	5	-1	4	-1
Processed metals	4	3	10	6	3	-7	-7	-3	-6	1	-8	-2
General-purpose machinery	11	15	14	3	12	-2	4	1	-2	-6	-4	-2
Production machinery	12	4	10	-2	9	-1	9	0	4	-5	-8	-12
Business oriented machinery	15	12	11	-4	8	-3	10	6	6	-4	4	-2
Electrical machinery	-7	-1	-6	1	5	11	-7	-10	-10	-3	-7	3
Shipbuilding & Heavy machinery, etc.	10	7	4	-6	-3	-7	9	9	13	4	8	-5
Motor vehicles	5	-1	-2	-7	3	5	3	6	0	-3	1	1
Basic materials	3	-1	6	3	4	-2	-10	-12	-9	1	-10	-1
Processing	7	5	6	-1	8	2	1	-1	-2	-3	-3	-1
Nonmanufacturing	22	17	19	-3	17	-2	4	-3	0	-4	-4	-4
Construction	45	32	36	-9	31	-5	10	-3	6	-4	-1	-7
Real estate	37	26	32	-5	28	-4	14	7	12	-2	5	-7
Goods rental & Leasing	17	23	20	3	17	-3	14	4	10	-4	8	-2
Wholesaling	2	4	10	8	5	-5	-5	-9	-6	-1	-8	-2
Retailing	18	13	11	-7	12	1	-10	-9	-16	-6	-17	-1
Transport & Postal activities	21	13	16	-5	10	-6	5	-6	2	-3	-5	-7
Communications	33	11	44	11	28	-16	26	14	16	-10	9	-7
Information services	31	24	27	-4	23	-4	16	10	12	-4	9	-3
Electric & Gas utilities	5	3	3	-2	2	-1	12	5	5	-7	5	0
Services for businesses	21	17	34	13	27	-7	5	1	7	2	0	-7
Services for individuals	16	27	11	-5	22	11	-1	-3	-1	0	-5	-4
Accommodations, Eating & Drinking services	22	19	11	-11	11	0	5	0	-17	-22	-11	6
All industries	13	11	12	-1	12	0	1	-4	-1	-2	-5	-4

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

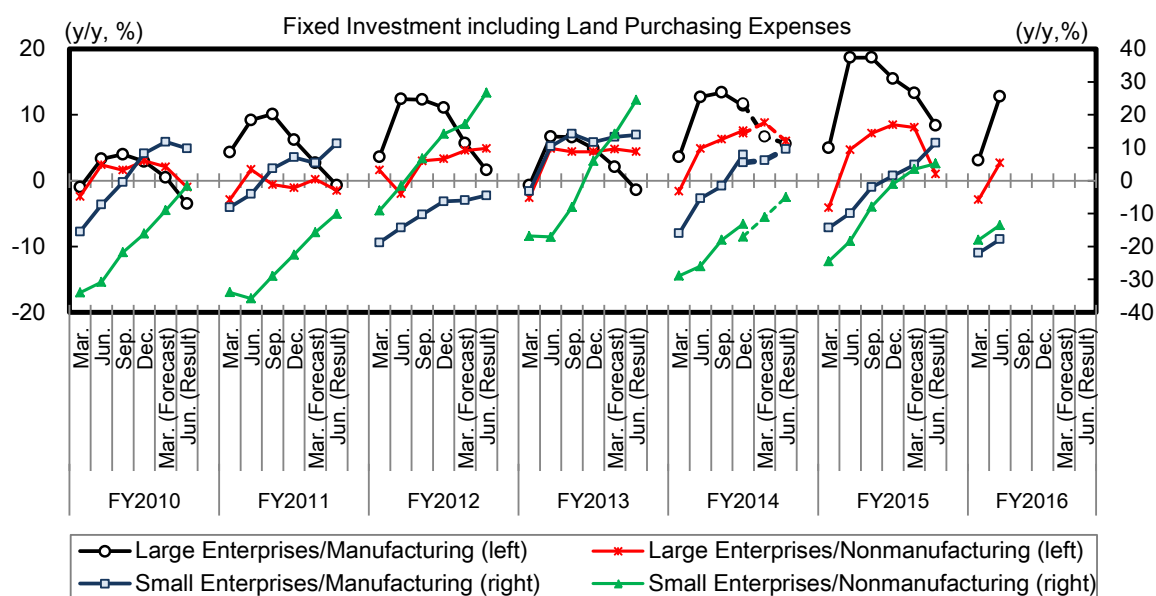
Sales		(Year-to-year % change)			Current Profits		(Year-to-year % change)		
		FY2015	FY2016 (Forecast)	Revision rate			FY2015	FY2016 (Forecast)	Revision rate
Large Enterprises	Manufacturing	-2.3	-0.5	-0.7	Large Enterprises	Manufacturing	-5.3	-11.6	-11.6
	Domestic Sales	-3.1	0.0	0.2		Basic materials	3.8	-3.4	3.3
	Exports	-0.3	-1.6	-2.5		Processing	-8.5	-14.9	-17.0
	Nonmanufacturing	-2.8	-0.8	-1.7		Nonmanufacturing	11.5	-3.4	-1.8
Medium-sized Enterprises	All industries	-2.6	-0.7	-1.3	Medium-sized Enterprises	All industries	2.8	-7.3	-6.5
	Manufacturing	0.5	0.7	-0.4		Manufacturing	8.0	-4.2	-3.1
	Nonmanufacturing	0.5	2.0	0.4		Nonmanufacturing	9.5	-3.7	-1.6
Small Enterprises	All industries	0.5	1.7	0.2	Small Enterprises	All industries	9.0	-3.8	-2.1
	Manufacturing	0.6	0.2	0.2		Manufacturing	3.4	1.1	1.8
	Nonmanufacturing	-0.3	-0.6	0.5		Nonmanufacturing	10.1	-12.8	-1.7
All Enterprises	All industries	-0.1	-0.4	0.4	All Enterprises	All industries	8.4	-9.5	-0.8
	Manufacturing	-1.4	-0.2	-0.5		Manufacturing	-2.9	-9.3	-9.0
	Nonmanufacturing	-1.3	-0.1	-0.5		Nonmanufacturing	10.8	-5.8	-1.7
		-1.3	-0.1	-0.5			4.8	-7.2	-4.7

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)		(Year-to-year % change)			Software Investment		(Year-to-year % change)		
		FY2015	FY2016 (Forecast)	Revision rate			FY2015	FY2016 (Forecast)	Revision rate
Large Enterprises	Manufacturing	8.4	12.8	4.7	Large Enterprises	Manufacturing	4.9	1.3	5.9
	Nonmanufacturing	1.0	2.7	-1.1		Nonmanufacturing	-2.2	7.5	3.0
	All industries	3.4	6.2	0.9		All industries	0.2	5.3	4.0
Medium-sized Enterprises	Manufacturing	9.3	5.8	2.5	Medium-sized Enterprises	Manufacturing	3.0	-3.5	-2.5
	Nonmanufacturing	8.3	-10.2	3.7		Nonmanufacturing	14.8	2.1	-1.0
	All industries	8.7	-4.6	3.2		All industries	12.9	1.3	-1.2
Small Enterprises	Manufacturing	11.5	-17.8	12.3	Small Enterprises	Manufacturing	-6.3	-5.0	8.1
	Nonmanufacturing	5.2	-13.5	7.3		Nonmanufacturing	-8.6	3.6	9.7
	All industries	7.2	-14.9	8.8		All industries	-7.9	1.0	9.3
All Enterprises	Manufacturing	9.1	6.0	5.3	All Enterprises	Manufacturing	3.9	0.6	5.5
	Nonmanufacturing	2.9	-2.5	1.0		Nonmanufacturing	0.0	6.2	2.8
	All industries	5.0	0.4	2.5		All industries	1.2	4.4	3.6



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.