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BOJ September 2016 Tankan Survey

Large enterprises continue to face uphill battle; caution urged regarding downward revision of corporate earnings

Economic Intelligence Team
Satoshi Osanai
Shunsuke Kobayashi

Summary

- In the BOJ September Tankan survey of corporate sentiment, the current trend in business sentiment for large enterprises in the manufacturing sector continues to be stagnant, while business sentiment amongst large enterprises in the non-manufacturing sector is worsening, indicating that businesses continue to face an uphill battle. While capital expenditure is seen as maintaining a firm undertone despite business sentiment, we believe caution regarding downside risk associated with worsening corporate performance in the future is still to be recommended.
- The business conditions DI for large manufacturers was flat at +6%pt in comparison with last survey's +6%pt, falling just short of market consensus at +7%pt. Business conditions DI for large non-manufacturing industries worsened slightly at +18%pt in comparison to the previous survey at +19%pt, keeping in line with market consensus at +18%pt.
- Sales projections of large enterprises (all industries) for FY2016 fell by -1.6% y/y, with current profit projections down by -9.2% y/y. Both sales and current 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 current profit projections were revised downwards considerably, with a revision rate of -3.3%. A further downward revision on the current survey represents a negative factor.
- 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 +1.7% y/y, an upward revision from the previous report (+0.4%). Due to a statistical quirk, capex projections tend to be revised upwards on the September BOJ Tankan survey, especially in the case of small enterprises. The upward revision on the September Tankan survey is about the same as the average year. At the same time, it should be noted that revisions for small enterprises were weak in comparison to past trends.

Results for large enterprises lacking

In the BOJ September Tankan survey of corporate sentiment, the current trend in business sentiment for large enterprises in the manufacturing sector continues to be stagnant, while business sentiment amongst large enterprises in the non-manufacturing sector is worsening, indicating that businesses continue to face an uphill battle. While capital expenditure is seen as maintaining a firm undertone despite business sentiment, we believe caution regarding downside risk associated with worsening corporate performance in the future is still to be recommended. The DIR outlook for Japan's economy sees some industries showing improvement after the recent economic lull, but with the absence of any clear driving force, downside risk generated by overseas economic factors remains. The BOJ September Tankan survey appears to echo our basic view.

There were no surprises in the current results, hence influence on government economic policy and BOJ monetary policy is expected to be limited. As for government economic policy, the most important question is whether the supplementary budget, which is expected to pass during the extraordinary Diet session called on September 26, is soundly executed and leads to economic revival. Meanwhile, as for monetary policy, we expect all eyes to be on the following two factors in the BOJ Outlook for Economic Activity and Prices, scheduled to be released on November 1: (1) the extent to which the outlook for prices is revised downwards, and (2) whether there is any change in the current inflation target, which is set for some time in FY2017.

The results of the BOJ June Tankan survey did not reflect the influence of the decision of the UK to withdraw from the EU, but expected it to become a downside factor on the September survey. However, seen in the short-term, factors such as turmoil in the global financial markets appeared to have settled down by summer. Hence, it seems safe to conclude that influence on the September Tankan survey was limited.

The business conditions DI for large manufacturers was flat at +6%pt in comparison with last survey's +6%pt, falling just short of market consensus at +7%pt. While the UK decision to leave the EU, followed by the progressive appreciation of the yen, worked negatively for the manufacturing industry, the return of calm to the global financial markets appears to have brought underlying support for exports of automobiles and electronic parts, which appear to have bottomed out.

The basic materials industries improved at +7%pt in comparison to the previous survey's +6%pt. As for performance of individual industries, chemicals worsened due to the rising cost of raw materials. Meanwhile, petroleum & coal products continued sluggish performance, worsening just slightly. On the other hand, iron & steel improved considerably, along with lumber & wood products. As for iron & steel, improvement in the international steel market, which had been worsening due mainly to excess supply on the part of Chinese steel manufacturers, brought a positive factor into the mix. However, yen appreciation remained a major drag on business sentiment, with business conditions DI continuing their low at the zero level. Ceramics, stone & clay, as well as non-ferrous metals, saw improvements which were most likely a rebound from the recent negative trend experienced by these industries.

The processing industries saw a slight improvement in business sentiment for the first time in five quarters at +7%pt in comparison to the previous survey's +6%pt. However, a large number of industries out of the total surveyed actually worsened, so the situation doesn't really allow for much optimism. As for performance by industry, business conditions worsened considerably for shipbuilding, heavy machinery, and other transportation machinery. These areas all took a hit from yen appreciation and the downturn in orders. Meanwhile, production machinery, business oriented machinery, and general-purpose machinery worsened, reflecting yen appreciation and weak external demand. On the other hand, improvements were seen for electrical machinery and automobiles despite the negative factor of yen appreciation. This was made possible by positive factors, including the waning influence

of the effects of the Kumamoto earthquake, and signs that electronic parts exports to Asia may soon hit bottom. As for exports of electronic parts to Asia, it is likely that manufacturing oriented toward popular new model smartphones was influential. As for automobiles, it is thought that the gradual decrease in the effects of the problem of falsification of data on fuel economy was a positive factor.

Business conditions DI for large non-manufacturing industries worsened slightly at +18%pt in comparison to the previous survey at +19%pt, keeping in line with market consensus at +18%pt. The continued sluggishness in domestic demand was a negative factor for the non-manufacturing industries, in addition to the slowdown in inbound consumption in relation to the strong yen. However, the level of business conditions DI remains high, so it is thought that there is no need for excessive pessimism.

Looking at performance by industry, it is notable that business conditions DI worsened for the retailing industry. This is due to a major decline in per capita expenditure on the part of tourists visiting Japan (inbound demand from foreign tourists), in addition to the lingering effects of the series of typhoons which hit Japan between late summer and early fall. Other industries also worsened, including transport & postal activities, information services, and services for businesses. There are growing signs that business conditions DI is about to peak out for transport & postal activities, and information services, and it is also possible that there are some abnormal conditions in the business environment. As for services for businesses, the reaction decline after the major improvement experienced on the previous survey had major influence, though its level remains high. Industries which were noteworthy due to their improvement were construction and real estate. Up to now it was assumed that these industries were about to peak out due to the recent slowdown in public investment and the reaction to the rapid improvement experienced until now, but business conditions DI continues to be favorable. The one weak point to watch out for is in real estate, where sales volume of condominiums have recently declined and the contract ratio is weak. Meanwhile, the business conditions DI of services for individuals, and accommodations, eating & drinking services has improved. However, this is largely a rebound from the previous survey, and the slowdown in inbound consumption creates a drag on performance, along with stagnant domestic demand.

Cautious stance expected to continue in future

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 -2%pt in comparison with the current survey at +16%pt. Corporations are clearly showing that they will be cautious regarding the future, due to yen appreciation, the slowdown in overseas economies, and stagnant personal consumption.

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 decreased (worsened) while non-manufacturing was flat. As for manufacturing, the situation was unsatisfactory due to the effects of yen appreciation, while in the area of non-manufacturing, personal consumption was weak and domestic capex had something to be desired, causing a continued drag on performance. As for large manufacturers' supply-demand conditions DI for overseas products and services, there was a slight improvement of -7%pt in comparison to the previous survey (-8%pt), but this factor is still moving in the negative range, and the influence of the overseas economic slowdown is seen as continuing.

Large manufacturers' FY2016 current profit projections to be revised downwards again

Sales projections of large enterprises (all industries) for FY2016 fell by -1.6% y/y, with current profit projections down by -9.2% y/y. Both sales and current 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 current profit projections were revised downwards considerably, with a revision rate of -3.3%. A further downward revision on the current survey represents a negative factor, which bodes ill for year-end financial statements.

The assumed exchange rate for the second half of FY2016 for large manufacturers is 107.42 yen to the dollar, a major revision in the direction of a strong yen in comparison to the previous survey's 111.36 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.

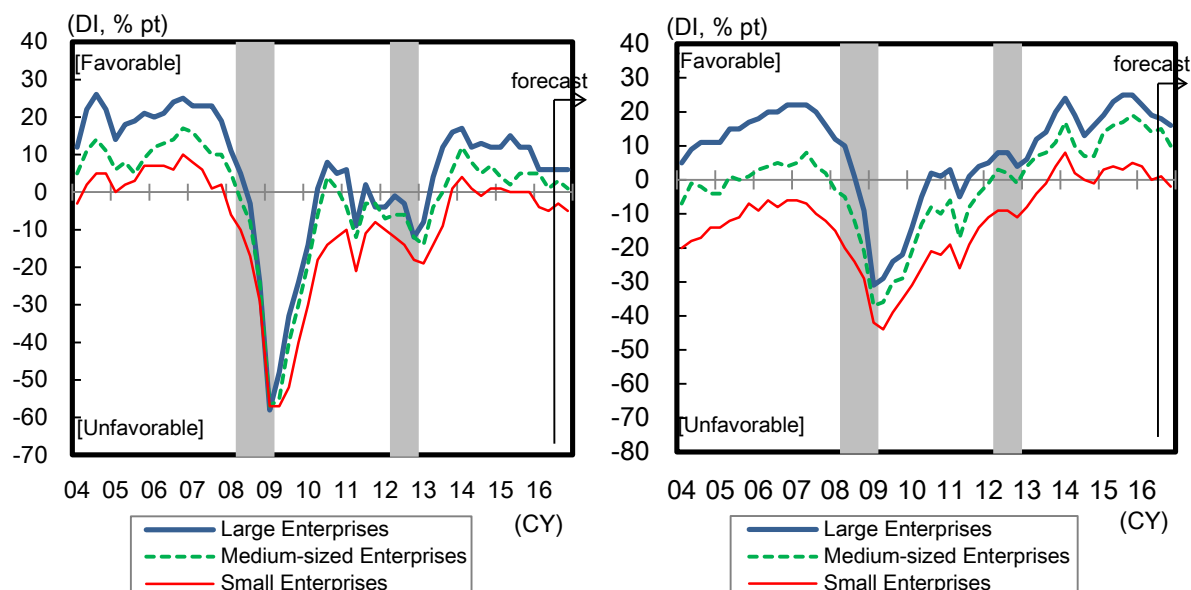
Revision of capital spending plans to remain at level of average year

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 +1.7% y/y, an upward revision from the previous report (+0.4%). Due to a statistical quirk, capex projections tend to be revised upwards on the September BOJ Tankan survey, especially in the case of small enterprises. The upward revision on the September Tankan survey is about the same as the average year. Business performance for the non-manufacturing industries maintained a firm undertone, and some calm has been regained regarding past problems such as the manpower shortage and the effects of the UK announcement that it would leave the EU. This has brought some positive effects. At the same time, export oriented manufacturers suffered negative effects from the progressive yen appreciation since last year. The capex projection for large enterprises in all industries was revised upwards to +6.3% y/y, while falling below market consensus at +6.7%. Looking at large enterprises by industry, we see that the manufacturing industry's capex projections for FY2016 grew by +12.7% 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. At the same time, it should be noted that revisions for small enterprises were weak in comparison to past trends.

Looking at production capacity DI for large manufacturers, we see that it was at +3%pt, a small decline in comparison to the previous survey (+4%), which represents an improvement. Meanwhile, large non-manufacturers were at -1%pt, a decline in comparison to the previous survey which was at 0%pt (this means an improvement). Both were flat for the future. The results on the June Tankan survey give us a general sense that production capacity DI is taking a breather in its recent downward tendency. Considering the results of the current survey, there should be no worries regarding overcapacity.

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.

	Large Enterprises						Small Enterprises					
	June 2016 Survey		Sept. 2016 Survey				June 2016 Survey		Sept. 2016 Survey			
	Actual	Forecast	Actual result	Forecast	Changes	Changes	Actual	Forecast	Actual result	Forecast	Changes	Changes
	result						result					
Manufacturing	6	6	6	0	6	0	-5	-7	-3	2	-5	-2
Textiles	-3	-6	-3	0	-6	-3	-16	-17	-19	-3	-24	-5
Lumber & Wood products	29	18	41	12	29	-12	-5	-11	-6	-1	-5	1
Pulp & Paper	7	11	14	7	7	-7	-18	-18	-14	4	-19	-5
Chemicals	11	7	6	-5	8	2	9	2	7	-2	0	-7
Petroleum & Coal products	6	5	5	-1	11	6	-28	-17	-17	11	-14	3
Ceramics, Stone & Clay	3	12	5	2	7	2	-10	-8	-10	0	-2	8
Iron & Steel	-12	-9	0	12	2	2	-14	-16	-10	4	-5	5
Nonferrous metals	3	-6	8	5	3	-5	-7	-7	-1	6	-1	0
Food & Beverages	29	17	28	-1	16	-12	5	4	7	2	6	-1
Processed metals	10	3	8	-2	3	-5	-6	-8	-5	1	-3	2
General-purpose machinery	14	12	6	-8	14	8	-2	-4	0	2	4	4
Production machinery	10	9	6	-4	8	2	4	-8	1	-3	-5	-6
Business oriented machinery	11	8	10	-1	20	10	6	4	6	0	10	4
Electrical machinery	-6	5	-5	1	3	8	-10	-7	-7	3	-6	1
Shipbuilding & Heavy machinery, etc.	4	-3	-18	-22	-18	0	13	8	14	1	1	-13
Motor vehicles	-2	3	8	10	3	-5	0	1	4	4	2	-2
Basic materials	6	4	7	1	7	0	-9	-10	-8	1	-8	0
Processing	6	8	7	1	6	-1	-2	-3	0	2	-1	-1
Nonmanufacturing	19	17	18	-1	16	-2	0	-4	1	1	-2	-3
Construction	36	31	39	3	30	-9	6	-1	9	3	-1	-10
Real estate	32	28	35	3	29	-6	12	5	8	-4	8	0
Goods rental & Leasing	20	17	23	3	17	-6	10	8	12	2	10	-2
Wholesaling	10	5	10	0	7	-3	-6	-8	-8	-2	-9	-1
Retailing	11	12	7	-4	12	5	-16	-17	-13	3	-8	5
Transport & Postal activities	16	10	6	-10	3	-3	2	-5	1	-1	-3	-4
Communications	44	28	44	0	33	-11	16	9	11	-5	17	6
Information services	27	23	19	-8	17	-2	12	9	9	-3	3	-6
Electric & Gas utilities	3	2	3	0	5	2	5	5	5	0	8	3
Services for businesses	34	27	29	-5	27	-2	7	0	7	0	2	-5
Services for individuals	11	22	26	15	20	-6	-1	-5	-7	-6	-6	1
Accommodations, Eating & Drinking services	11	11	12	1	8	-4	-17	-11	-2	15	0	2
All industries	12	12	12	0	11	-1	-1	-5	0	1	-3	-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)			Current Profits		(Year-to-year % change)		
		FY2015	FY2016				FY2015	FY2016	
			(Forecast)	Revision rate				(Forecast)	Revision rate
Large Enterprises	Manufacturing	-2.3	-1.7	-1.2	Large Enterprises	Manufacturing	-5.3	-14.6	-3.3
	Domestic Sales	-3.1	-0.8	-0.8		Basic materials	3.8	-2.4	1.1
	Exports	-0.3	-3.7	-2.1		Processing	-8.5	-19.4	-5.3
	Nonmanufacturing	-2.8	-1.6	-0.8		Nonmanufacturing	11.5	-4.2	-0.8
	All industries	-2.6	-1.6	-1.0		All industries	2.8	-9.2	-2.0
Medium-sized Enterprises	Manufacturing	0.5	0.0	-0.6	Medium-sized Enterprises	Manufacturing	8.0	-6.0	-1.9
	Nonmanufacturing	0.5	1.4	-0.6		Nonmanufacturing	9.5	-3.1	0.6
	All industries	0.5	1.1	-0.6		All industries	9.0	-4.0	-0.2
Small Enterprises	Manufacturing	0.6	-0.3	-0.6	Small Enterprises	Manufacturing	3.4	0.3	-0.8
	Nonmanufacturing	-0.3	-1.0	-0.4		Nonmanufacturing	10.1	-10.6	2.5
	All industries	-0.1	-0.9	-0.5		All industries	8.4	-8.0	1.6
All Enterprises	Manufacturing	-1.4	-1.2	-1.0	All Enterprises	Manufacturing	-2.9	-11.8	-2.8
	Nonmanufacturing	-1.3	-0.7	-0.6		Nonmanufacturing	10.8	-5.6	0.2
	All industries	-1.3	-0.9	-0.7		All industries	4.8	-8.1	-1.0

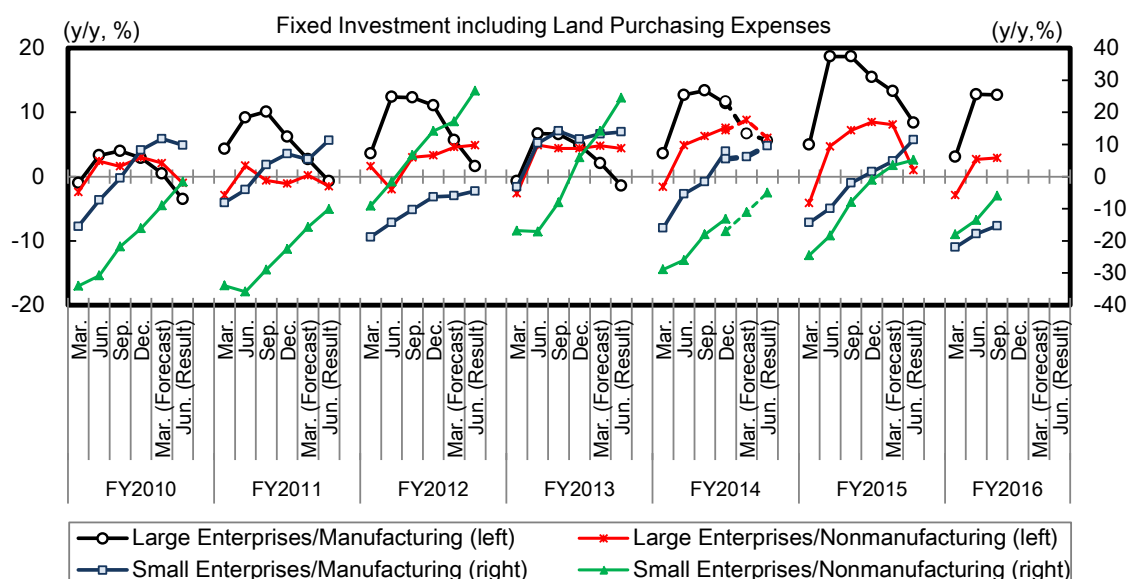
Note: Revision rates are calculated as the percentage change of the figures between the current and the previous survey.

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)			Software Investment		(Year-to-year % change)		
		FY2015	FY2016				FY2015	FY2016	
			(Forecast)	Revision rate				(Forecast)	Revision rate
Large Enterprises	Manufacturing	8.4	12.7	-0.1	Large Enterprises	Manufacturing	4.9	-0.3	-1.6
	Nonmanufacturing	1.0	2.9	0.1		Nonmanufacturing	-2.2	6.4	-1.0
	All industries	3.4	6.3	0.1		All industries	0.2	4.0	-1.2
Medium-sized Enterprises	Manufacturing	9.3	4.4	-1.4	Medium-sized Enterprises	Manufacturing	3.0	-3.4	0.1
	Nonmanufacturing	8.3	-8.3	2.1		Nonmanufacturing	14.8	5.4	3.3
	All industries	8.7	-3.9	0.7		All industries	12.9	4.1	2.8
Small Enterprises	Manufacturing	11.5	-15.3	3.0	Small Enterprises	Manufacturing	-6.3	4.6	10.1
	Nonmanufacturing	5.2	-6.0	8.6		Nonmanufacturing	-8.6	4.6	1.0
	All industries	7.2	-9.0	6.9		All industries	-7.9	4.6	3.6
All Enterprises	Manufacturing	9.1	6.1	0.2	All Enterprises	Manufacturing	3.9	-0.1	-0.7
	Nonmanufacturing	2.9	-0.6	1.9		Nonmanufacturing	0.0	6.1	-0.1
	All industries	5.0	1.7	1.3		All industries	1.2	4.0	-0.3



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.