Daiwa
Daiwa Institute of Research

15 December 2016 (No. of pages: 6)

Japanese report: 14 Dec 2016

BOJ December 2016 Tankan Survey

Business sentiment of large enterprises improves. Election of Trump appears to have had limited effect on Tankan Survey

Economic Intelligence Team
Satoshi Osanai
Shunsuke Kobayashi

Summary

- In the BOJ December Tankan survey of corporate sentiment, the current trend in business sentiment for large enterprises in the manufacturing sector has notably improved after a period of weakening. On the other hand, capital expenditure remains weak. Corporate sentiment regarding the future remains cautious, but considering recent improvements in the economic and financial environments, we believe there is no need for excessive concern.

- The BOJ December Tankan survey makes use of information collected just after the US presidential election held on November 8 when the yen experienced major depreciation in reaction to Republican Donald Trump's win. Trump's effect on the market may actually have been a plus to the business conditions DI of some export-driven manufacturers. However, corporations do not normally change their business plans for the fiscal year on a monthly basis, so this does not appear to have had any real effect on assumed exchange rates, profit projections or capex projections.

- The business conditions DI for large manufacturers grew to +10%pt in comparison with last survey's +6%pt, in agreement with market consensus at +10%pt. Business conditions DI for large non-manufacturing industries marked time at +18%pt in comparison to the previous survey at +18%pt, while falling below market consensus at +19%pt.

- Sales projections of large enterprises (all industries) for FY2016 fell by -3.2% y/y, with current profit projections down by -11.6% y/y. Both sales and current profit projections were revised downwards due to sluggish exports and weak personal consumption.

- 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 +1.8% y/y, a slight upward revision from the previous report (+1.7%). Due to a statistical quirk, capex projections tend to be revised upwards on the December BOJ Tankan survey, especially in the case of small enterprises. However, the upward revision on the December Tankan survey is a bit on the weak side compared to the average year.

Business sentiment of manufacturing sector improves

In the BOJ December Tankan survey of corporate sentiment, the current trend in business sentiment for large enterprises in the manufacturing sector has notably improved after a period of weakening. On the other hand, capital expenditure remains weak. Corporate sentiment regarding the future remains cautious, but considering recent improvements in the economic and financial environments, we believe there is no need for excessive concern. The DIR outlook for Japan's economy sees movement toward a comeback bringing it out of its previous lull, and the December results of the BOJ Tankan are consistent with our opinion.

There were no surprises in the current results, and in the short-term, Trump's effect on the market actually brings a possible upward swing for the economy just over the horizon. Hence, hopes and expectations of a government economic stimulus package as were seen in the past, or further monetary easing on the part of the BOJ, are not likely to as much on the minds of businesses. Our basic scenario sees the BOJ maintaining its current monetary policy for the time being.

The BOJ December Tankan survey makes use of information collected just after the US presidential election held on November 8 when the yen experienced major depreciation in reaction to Republican Donald Trump's win. Trump's effect on the market may actually have been a plus to the business conditions DI of some export-driven manufacturers. However, corporations do not normally change their business plans for the fiscal year on a monthly basis, so this does not appear to have had any real effect on assumed exchange rates, sales and profit projections or capex projections.

The business conditions DI for large manufacturers grew to +10%pt in comparison with last survey's +6%pt, in agreement with market consensus at +10%pt. The yen's depreciation since the beginning of fall on top of signs that the overseas economy is making a comeback seems to have been a plus, as well as growth in the price of energy and materials.

The basic materials industries improved somewhat at +8%pt in comparison to the previous survey's +7%pt, but all in all was marking time. As for performance of individual industries, petroleum & coal products improved along with non-ferrous metals due to the increase in the price of energy and materials. On the other hand, iron & steel worsened, along with pulp & paper. As for iron & steel, growth in the price of iron and steel products was a plus. However, the market for coking coal was at a high and continued oversupply on the part of Chinese iron & steel manufacturers remained a major drag on business sentiment. Pulp & paper saw input costs increase due to the rising cost of raw materials, and this caused a drag on overall performance.

The processing industries saw improvement in business sentiment for the second consecutive quarter at +10%pt in comparison to the previous survey's +7%pt. As for performance by industry, business conditions improved for electrical machinery, automobiles, general-purpose machinery, and production machinery. As for electrical machinery, yen depreciation and the underlying strength of electronic parts exports to Asia were thought to have been a plus. In regard to electronic parts exports to Asia, orders oriented toward popular new model smartphones continued to be favorable, leading to growth in exports. As for automobiles, domestic new car sales volume and export volume both moving toward a comeback were thought to have encouraged improvement, as well as the progressively weak yen. As for general-purpose machinery and production machinery, the business environment has been improving of late as can be seen in the growth in shipments of capital goods, and this has encouraged the positive tone. Meanwhile, there is a good possibility that reconstruction demand associated with the Kumamoto earthquake earlier this year continues to be a plus. On the other hand, food & beverages and shipbuilding & heavy machinery, etc. worsened. In the case of food & beverages, this was thought to be a reactionary decline following the high pace of improvement until this point, as well as the increase in the price of raw materials, bringing on a strong sense that the industry was about to peak out. As for shipbuilding & heavy machinery, etc. the environment for orders received had been weakening of late, and this caused a drag on performance.

Business conditions DI for large non-manufacturing industries marked time at +18%pt in comparison to the previous survey at +18%pt, while falling below market consensus at +19%pt. In addition to the continued sluggishness in domestic demand bringing downward pressure on the non-manufacturing industries, the slowdown in inbound consumption associated with yen appreciation which lasted through summer worked negatively for related industries.

Looking at performance by industry, improvement in business conditions DI was seen in electric & gas utilities, services for businesses, information services, and construction. As for electric & gas utilities, yen appreciation through the summer led to a decline in input costs which was a plus, along with the time lag in this industry which stretched benefits from the decline somewhat beyond this point. Services for businesses and information services saw improvements in the corporate sector while at the same time benefitting from favorable investment in IT. As for construction, this reflects the fact that a positive business environment continues for the industry. On the other hand, business conditions DI worsened for retailing, services for individuals, and accommodations, eating & drinking services. These industries continue to be weighed down by the slowdown in inbound consumption creates a drag on performance, along with stagnant domestic demand. In other industries, real estate suffers due to declining sales volume of condominiums and a weak contract ratio. The industry has maintained a high level business conditions DI in the past, so there is no need to be excessively concerned, however, the December Tankan Survey may indicate that the business environment for real estate is headed for a change.

Cautious stance expected to continue in future, but no need for concern

Looking at the future outlook of business conditions DI, large enterprises in the manufacturing sector are expected to be at +8%pt (a worsening of -2%pt in comparison to the current survey), while large enterprises in the non-manufacturing sector are seen worsening by -2%pt in comparison with the current survey at +16%pt. This shows that corporations remain cautious regarding the future. However, the current survey has not included data such as the possibility that in the short-term, Trump's effect on the market may actually bring an upward swing for the economy. It is quite possible that this month's survey shows business sentiment to be on the low side in comparison to the actual economic and financial environment that has been developing recently.

Overseas supply and demand for the manufacturing industry improves slightly for the third consecutive quarter

Taking a look at supply-demand conditions DI in the areas of domestic products and services for large enterprises, we see that both manufacturing and non-manufacturing grew (improved). As for manufacturing, the growth trend in consumption of durables is thought to have been a plus. Meanwhile, non-manufacturing continues to mark time. It appears that weak and domestic capex continues to be a drag on performance. As for large manufacturers' supply-demand conditions DI for overseas products and services, there was a slight improvement of -6%pt in comparison to the previous survey (-7%pt). Though still moving in the negative range, it is notable that there has been improvement for three consecutive quarters, reflecting improvement in the overseas economy.

Meanwhile, regarding price conditions, the output price conditions DI and the input price conditions DI for both large manufacturing and non-manufacturing enterprises grew due to the increase in the price of crude oil and the progressively weak yen. However, since the extent of growth was larger for the input price conditions DI, this meant a worsening of terms of trade (output price conditions DI –

input price conditions DI) for both manufacturing and non-manufacturing. This may work in the negative direction when it comes to profits, hence caution is required.

Large manufacturers' FY2016 current profit projections revised downwards again

Sales projections of large enterprises (all industries) for FY2016 fell by -3.2% y/y, with current profit projections down by -11.6% y/y. Both sales and current profit projections were revised downwards due to sluggish exports and weak personal consumption. As was pointed out earlier in this report, the yen experienced major depreciation after Donald Trump won the US election, but corporations have not changed their profit projections on the BOJ Tankan, as these projections are not normally changed on a monthly basis. Hence the Trump effect appears to be minimal in these results.

The assumed exchange rate for the second half of FY2016 for large manufacturers is 103.36 yen to the dollar, revised upwards in comparison to the previous survey's 107.42 yen to the dollar. However, the actual yen rate currently shows a significantly weaker yen than the assumed rate. Hence the current profit projections of export-driven manufacturers are likely higher than on the December BOJ Tankan.

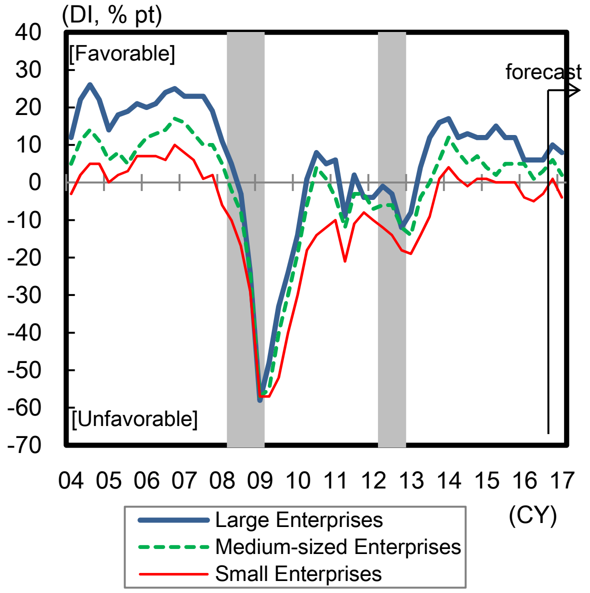
Capital spending plans on the weak side compared to the average year

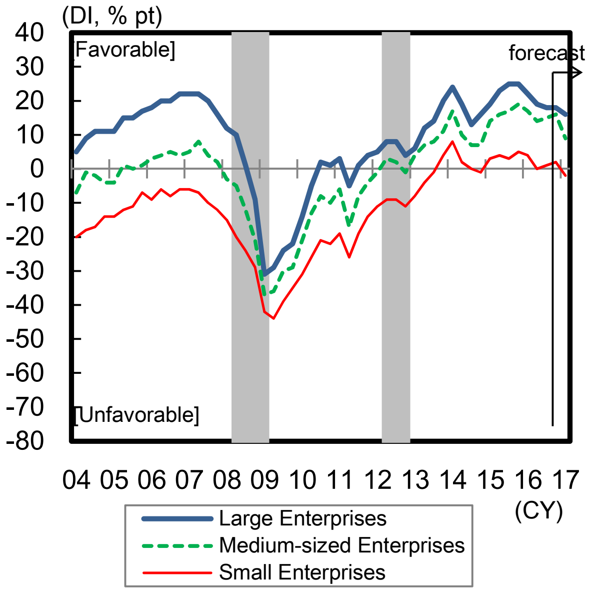
The FY 2016 capex projection for all enterprises in all industries (incl. investment in properties but excl. that in software; all industries, all companies) is +1.8% y/y, a slight upward revision from the previous report (+1.7%). Due to a statistical quirk, capex projections tend to be revised upwards on the December BOJ Tankan survey, especially in the case of small enterprises. However, the upward revision on the December Tankan survey is a bit on the weak side compared to the average year.

Business performance for large and small enterprises in non-manufacturing was notably weak. The non-manufacturing industries were favorable, and it was expected that a firm undertone would be maintained due to manpower shortage, but results were a bit on the negative side. The capex projection for large enterprises in all industries was revised downwards to +5.5% y/y, while falling below market consensus at +6.1%. Looking at large enterprises by industry, we see that the manufacturing industry's capex projections for FY2016 grew by +11.2% y/y, within the range of revisions in the average year. On the other hand, large enterprises in the non-manufacturing sector were at +2.5% y/y, falling below the pattern of revisions for the average year.

Looking at production capacity DI for large manufacturers, we see that it was at +1%pt, a decline in comparison to the previous survey (+3%), which represents an improvement. Meanwhile, large non-manufacturers were at -2%pt, a decline in comparison to the previous survey which was at -1%pt (this means an improvement). Both grew (worsened) in the future projection. Considering the results of the current survey, there are no signs of overcapacity for large enterprises.

Business Conditions DI — Chart 1





Source: Bank of Japan, Cabinet Office; 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					
	Sept. 2016 Survey		Dec. 2016 Survey				Sept. 2016 Survey		Dec. 2016 Survey			
	Actual result	Forecast	Actual result	Changes	Forecast	Changes	Actual result	Forecast	Actual result	Changes	Forecast	Changes
Manufacturing	6	6	10	4	8	-2	-3	-5	1	4	-4	-5
Textiles	-3	-6	-3	0	-3	0	-19	-24	-23	-4	-32	-9
Lumber & Wood products	41	29	41	0	29	-12	-6	-5	6	12	-7	-13
Pulp & Paper	14	7	11	-3	4	-7	-14	-19	-11	3	-11	0
Chemicals	6	8	7	1	10	3	7	0	10	3	2	-8
Petroleum & Coal products	5	11	22	17	11	-11	-17	-14	-5	12	-16	-11
Ceramics, Stone & Clay	5	7	6	1	12	6	-10	-2	3	13	2	-1
Iron & Steel	0	2	-7	-7	-5	2	-10	-5	4	14	1	-3
Nonferrous metals	8	3	20	12	6	-14	-1	-1	9	10	4	-5
Food & Beverages	28	16	24	-4	12	-12	7	6	5	-2	1	-4
Processed metals	8	3	10	2	5	-5	-5	-3	-2	3	-4	-2
General-purpose machinery	6	14	14	8	12	-2	0	4	1	1	0	-1
Production machinery	6	8	10	4	10	0	1	-5	-3	-4	-9	-6
Business oriented machinery	10	20	10	0	10	0	6	10	2	-4	1	-1
Electrical machinery	-5	3	4	9	10	6	-7	-6	2	9	-1	-3
Shipbuilding & Heavy machinery, etc.	-18	-18	-25	-7	-14	11	14	1	9	-5	7	-2
Motor vehicles	8	3	10	2	12	2	4	2	15	11	6	-9
Basic materials	7	7	8	1	8	0	-8	-8	0	8	-7	-7
Processing	7	6	10	3	9	-1	0	-1	1	1	-2	-3
Nonmanufacturing	18	16	18	0	16	-2	1	-2	2	1	-2	-4
Construction	39	30	40	1	29	-11	9	-1	9	0	2	-7
Real estate	35	29	33	-2	27	-6	8	8	13	5	7	-6
Goods rental & Leasing	23	17	20	-3	20	0	12	10	18	6	16	-2
Wholesaling	10	7	9	-1	8	-1	-8	-9	-7	1	-11	-4
Retailing	7	12	3	-4	13	10	-13	-8	-10	3	-9	1
Transport & Postal activities	6	3	8	2	5	-3	1	-3	2	1	-3	-5
Communications	44	33	44	0	39	-5	11	17	16	5	12	-4
Information services	19	17	21	2	18	-3	9	3	11	2	6	-5
Electric & Gas utilities	3	5	8	5	5	-3	5	8	3	-2	5	2
Services for businesses	29	27	33	4	27	-6	7	2	6	-1	1	-5
Services for individuals	26	20	23	-3	18	-5	-7	-6	-7	0	-4	3
Accommodations, Eating & Drinking services	12	8	9	-3	11	2	-2	0	-2	0	-8	-6
All industries	12	11	14	2	13	-1	0	-3	2	2	-3	-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	FY2016 (Forecast)	Revision rate
Large Enterprises	Manufacturing	-2.3	-3.7	-2.0
	Domestic Sales	-3.1	-2.5	-1.7
	Exports	-0.3	-6.3	-2.7
	Nonmanufacturing	-2.8	-2.8	-1.3
	All industries	-2.6	-3.2	-1.6
Medium-sized Enterprises	Manufacturing	0.5	-0.4	-0.4
	Nonmanufacturing	0.5	1.3	-0.1
	All industries	0.5	0.9	-0.2
Small Enterprises	Manufacturing	0.6	-0.9	-0.5
	Nonmanufacturing	-0.3	-0.5	0.5
	All industries	-0.1	-0.6	0.3
All Enterprises	Manufacturing	-1.4	-2.7	-1.5
	Nonmanufacturing	-1.3	-1.1	-0.4
	All industries	-1.3	-1.6	-0.8

Current Profits (Year-to-year % change)

		FY2015	FY2016 (Forecast)	Revision rate
Large Enterprises	Manufacturing	-5.3	-18.9	-5.0
	Basic materials	3.8	-10.1	-7.9
	Processing	-8.5	-22.3	-3.6
	Nonmanufacturing	11.5	-4.9	-0.8
	All industries	2.8	-11.6	-2.6
Medium-sized Enterprises	Manufacturing	8.0	-5.3	0.8
	Nonmanufacturing	9.5	-0.3	2.9
	All industries	9.0	-1.8	2.3
Small Enterprises	Manufacturing	3.4	3.9	3.6
	Nonmanufacturing	10.1	-4.1	7.3
	All industries	8.4	-2.2	6.3
All Enterprises	Manufacturing	-2.9	-14.6	-3.1
	Nonmanufacturing	10.8	-3.9	1.9
	All industries	4.8	-8.2	-0.1

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

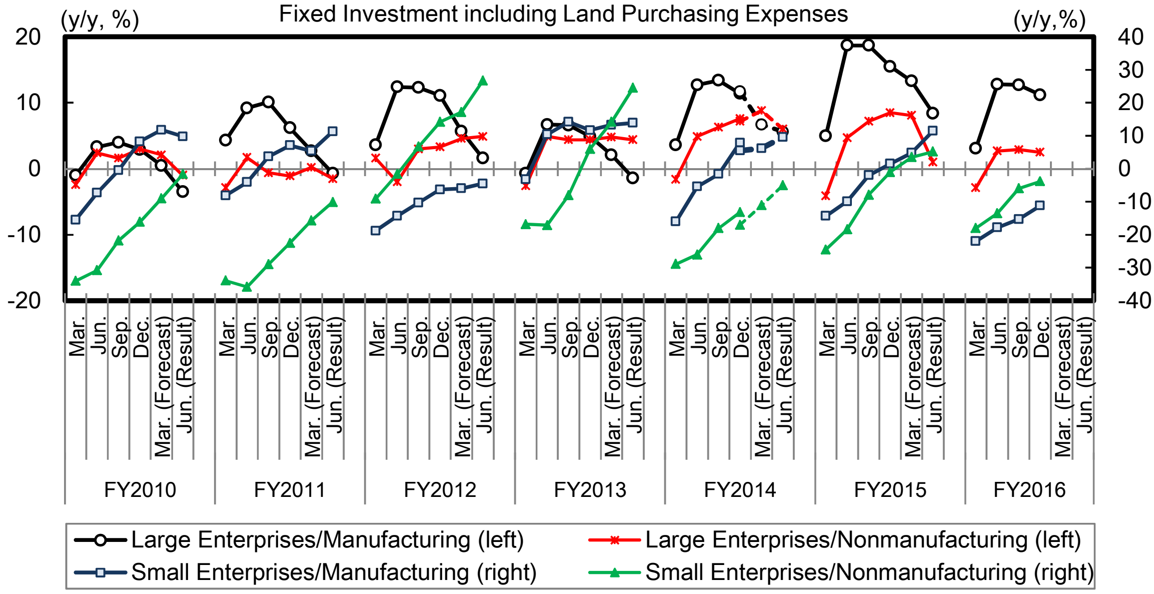
Developments of Fixed Investment including Land Purchasing Expenses (excl. software investment) — Chart 3

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

		FY2015	FY2016 (Forecast)	Revision rate
Large Enterprises	Manufacturing	8.4	11.2	-1.4
	Nonmanufacturing	1.0	2.5	-0.4
	All industries	3.4	5.5	-0.7
Medium-sized Enterprises	Manufacturing	9.3	2.4	-1.9
	Nonmanufacturing	8.3	-5.9	2.6
	All industries	8.7	-3.0	0.9
Small Enterprises	Manufacturing	11.5	-11.2	4.8
	Nonmanufacturing	5.2	-3.8	2.3
	All industries	7.2	-6.2	3.1
All Enterprises	Manufacturing	9.1	5.6	-0.5
	Nonmanufacturing	2.9	-0.1	0.6
	All industries	5.0	1.8	0.2

Software Investment (Year-to-year % change)

		FY2015	FY2016 (Forecast)	Revision rate
Large Enterprises	Manufacturing	4.9	-1.0	-0.7
	Nonmanufacturing	-2.2	7.9	1.5
	All industries	0.2	4.7	0.7
Medium-sized Enterprises	Manufacturing	3.0	-4.2	-0.8
	Nonmanufacturing	14.8	-2.2	-7.3
	All industries	12.9	-2.5	-6.4
Small Enterprises	Manufacturing	-6.3	5.5	0.9
	Nonmanufacturing	-8.6	6.5	1.8
	All industries	-7.9	6.2	1.5
All Enterprises	Manufacturing	3.9	-0.8	-0.6
	Nonmanufacturing	0.0	6.0	-0.1
	All industries	1.2	3.8	-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.