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BOJ September 2017 Tankan Survey

Improvement in manufacturing industry business sentiment exceeds expectations; manpower shortage remains strongly felt

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Summary

- In the BOJ September 2017 Tankan survey of corporate sentiment, the current trend in business sentiment in all industries was mixed. However, looking at business conditions DI in a comprehensive manner, corporate business sentiment in Japan continues to be positive. Especially notable is a step up in improvement of business sentiment in the manufacturing industry supported by the weak yen and improvement in exports. Meanwhile, considering the period covered by this survey (August 29 – September 29) the recent dissolution of the House of Representatives is seen as having no effect on the results of the September BOJ Tankan survey.

- The business conditions DI for large manufacturers grew to +22%pt in comparison with last survey's +17%pt, while at the same time exceeding market consensus considerably at +18%pt. Overseas economies continue to recover, and the positive effects of a weaker yen, especially in relation to the Euro, has been a positive factor, bringing the fourth consecutive quarter of improvement. Business conditions DI for large non-manufacturing industries marked time at +23%pt (also +23%pt on the previous survey). Market consensus was also +23%pt.

- The FY 2017 capex projection for all enterprises in all industries (incl. investment in properties but excl. that in software) is +4.6% y/y, exceeding market consensus (+4.3%). Looking at the performance of large enterprises by industry, we see that capex projections of manufacturers for FY2017 are up by +14.1%, while large enterprises in non-manufacturing are at +4.0%. This is more or less along the lines of past revisions.

- Employment conditions DI for corporations of all sizes in both manufacturing and non-manufacturing declined (supply/demand becoming tighter). The sense of a shortage of manpower is increasing amongst corporations. Employment conditions DI are expected to decline further in the future for both manufacturing and non-manufacturing centering on small and medium-size corporations, with the condition of the labor market expected to become increasingly tight. Some industries are seen as facing difficulties in acquiring the employees they need in the near future. These industries will likely be required to improve conditions for their employees, either in the form of accepting more as regular employees or by increasing wages. This will require investment in acquiring personnel as well as investment in labor-saving systems. Improving productivity will continue to be important in the future.

Japanese corporate business sentiment continues on the positive side

In the BOJ September 2017 Tankan survey of corporate sentiment, the current trend in business sentiment in all industries was mixed. However, looking at business conditions DI in a comprehensive manner, corporate business sentiment in Japan continues to be positive. Especially notable is a step up in improvement of business sentiment in the manufacturing industry supported by the weak yen and improvement in exports. Corporate sentiment regarding the future remains cautious, but considering the recent economic and financial environments, as well as the downward bias of the Tankan survey's outlooks for the future of late, we believe there is no need for excessive concern. Meanwhile, considering the period covered by this survey (August 29 – September 29) the recent dissolution of the House of Representatives is seen as having no effect on the results of the September BOJ Tankan survey.

Our current view for the Japanese economy sees a gradual improvement, and the September BOJ Tankan generally goes along with that view. Survey results can also be said to provide support for the BOJ's economic assessment which sees Japan's economy currently in a moderate expansion. We do not expect this viewpoint to change significantly on the BOJ's Outlook for Economic Activity and Prices to be issued on October 31. As for the future of monetary policy, the continuing moderate recovery suggests that the focus is likely to be more on the direction of inflation, which is lacking in strength, rather than the real economy.

The business conditions DI for large manufacturers grew to +22%pt in comparison with last survey's +17%pt, while at the same time exceeding market consensus considerably at +18%pt. Overseas economies continue to recover, and the positive effects of a weaker yen, especially in relation to the Euro, has been a positive factor, bringing the fourth consecutive quarter of improvement. The fact that results exceeded market consensus was an especially positive surprise considering the BOJ's June Tankan outlook which indicated worsening performance in the future. Also worthy of note is the fact that both the basic materials and processing industries showed improvement.

The basic materials industries improved at +21%pt in comparison to the previous survey's +17%pt, making this the sixth consecutive quarter of improvement. As for performance of individual industries, chemicals, petroleum & coal products, lumber & wood products, textiles, and pulp & paper saw improvement. As for chemicals, materials prices (sales price) have been increasing, and the improvement in profits is thought to have contributed positively. As for petroleum & coal products, the increase in the price of crude oil since summer is thought to have contributed to pushing up results. On the other hand, business sentiment worsened for nonferrous metals, iron & steel, and ceramics, stone & clay. In the case of nonferrous metals, this was due to a reactionary decline in response to major improvements on the previous survey. Considering the fact that the industry still maintains a high level of performance, we believe that this should not be taken as a negative sign. As for iron & steel, negative factors such as oversupply on the part of Chinese manufacturers and the high price of coal are gradually falling away, but like nonferrous metals, it is likely that this was due to a reactionary decline in response to major improvements on the previous survey.

The processing industries saw improvement in business sentiment for the fifth consecutive quarter at +23%pt in comparison to the previous survey's +17%pt. As for performance by industry, business conditions improved notably for the second consecutive quarter in the areas of general-purpose machinery, production machinery, business oriented machinery and electrical machinery. As for production machinery, and business oriented machinery, both exports and production maintained favorable performance, and this provided them with a boost. As for electrical machinery, the weak yen effect is continuing, and electronic parts exports to Asia are maintaining a high level, bringing a plus to business sentiment. Meanwhile, motor vehicles saw an improvement for the first time in two quarters due to the underlying strength of domestic car sales, and the rebound from the previous period's low performance.

Business conditions DI for large non-manufacturing industries marked time at +23%pt (also +23%pt on the previous survey). Market consensus was also +23%pt. Improvements continue supported by the comeback for consumption, favorable inbound demand, and brisk demand for construction and real estate. However, despite the continued high level of performance on the BOJ Tankan survey, bad weather and the home delivery crisis conspired to bring final results in marking time.

Looking at performance by industry, worsening of business conditions DI was seen in accommodations, eating & drinking services, communications, retailing, goods rental & leasing, and transport & postal activities. As for accommodations, eating & drinking services and retailing, the number of foreign tourists visiting Japan continued to increase, contributing on the plus side, but bad weather was a drag on consumption. Construction, real estate and personal services marked time. However, construction and real estate maintained a high level of business conditions DI due to favorable demand and low interest rates, and the business environment is expected to continue to be favorable. On the other hand, business conditions DI improved for wholesaling, services for businesses, electric & gas utilities, and information services. As for, electric & gas utilities, the drag on profits caused by the increase of energy costs and the time lag in gaining the benefits of price pass-through is beginning to fall away, and performance is moving in a positive direction.

Cautious stance continues from previous survey, but no need for concern

Looking at the future outlook for business conditions DI, large enterprises in the manufacturing sector are expected to be at +19%pt (a worsening of -3%pt in comparison to the current survey), while large enterprises in the non-manufacturing sector are seen at +19%pt (worsening by -4%pt in comparison with the current survey). This shows that corporations remain cautious regarding the future. This is due to the increase in geopolitical risk in the East Asia region associated with the North Korea problem, and the sense of uncertainty brought on by unknowns related to the policies of the Trump administration. However, the BOJ Tankan has had the tendency recently to announce cautious outlooks for the future, with real results coming in later which are good. This preference for making predictions on the low side is something which should not cause overly much concern.

Large enterprises in the manufacturing industry break out of the negative range in overseas supply & demand conditions for the first time in 37 quarters

As for the domestic supply & demand conditions for products and services DI of large enterprises, the manufacturing industry showed improvement for the fourth consecutive quarter, while non-manufacturing marked time. As for manufacturing, it appears that improvements in exports and production associated with the recovery of overseas economies had a positive effect. The overseas supply & demand conditions for products and services DI of large enterprises in manufacturing was at 0%pt, an improvement in comparison to the previous survey when it was at -2%pt. This component has improved for six consecutive quarters reflecting the recovery trend in overseas economies. The last time large enterprises in manufacturing managed to pull out of the negative numbers in this DI was on the June Tankan survey in the year 2008, a total of 37 quarters ago.

Meanwhile, the output prices DI rose for large enterprises in the manufacturing industry, but fell for large enterprises in non-manufacturing. Supply & demand conditions for labor remain especially tight for the non-manufacturing industry and this brings upward pressure on costs, but it appears that efforts toward price pass-through are limited. This seems to be consistent with the CPI statistics according to which the prevailing price for general services is depressed. As for terms of trade (output prices DI –

input prices DI) large enterprises in the manufacturing industry marked time, while large enterprises in non-manufacturing worsened.

Large manufacturers maintain projections for sales growth in FY2017

Sales projections of large enterprises (all industries) for FY2017 were revised upwards by +2.8% y/y (a revision rate of +0.2%), reflecting the effects of the rebound from the decline in earnings experienced during FY2016. The result of sales growth was a plus.

Current profit projections were also revised upwards significantly at +1.3% (a revision rate of +4.5%). Most notable is the manufacturing industry registered an upward revision due to the increase in exports backed by the recovery in the overseas economy, as well as the weak yen. The assumed exchange rate for FY2017 for large manufacturers is 109.29 yen to the dollar, a revision in the direction of a weaker yen in comparison to the previous survey's 108.31 yen to the dollar. The current yen rate shows a significantly weaker yen than the assumed rate. Hence the current profit projections (actual value) of export-driven manufacturers for the full FY2017 period will likely be higher than on the September BOJ Tankan. Meanwhile, a big focus on announcements of corporate business performance starting at the end of October will be the extent to which manufacturing industry business performance is revised upwards.

FY2017 research & development investment promises to maintain underlying strength

The FY 2017 capex projection for all enterprises in all industries (incl. investment in properties but excl. that in software) is +4.6% y/y, exceeding market consensus (+4.3%). Looking at the performance of large enterprises by industry, we see that capex projections of manufacturers for FY2017 are up by +14.1%, while large enterprises in non-manufacturing are at +4.0%. This is more or less along the lines of past revisions.

Meanwhile, research & development investment, which is being publically announced for the first time on the March Tankan survey, was revised upwards somewhat by +2.9% for corporations of all sizes in all industries. As for revision tendencies in the future, it will be necessary to monitor closely, but continued underlying strength is promising.

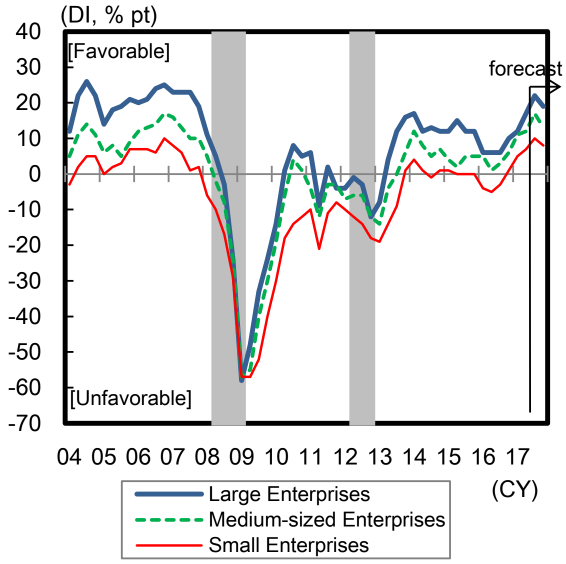
Looking at production capacity DI for large manufacturers, we see that it was marking time at -1%pt in comparison to the previous survey's -1%, while large non-manufacturers were at -2%pt in comparison to the previous survey which was at -1%pt (this represents an improvement). Overall, the sense of overcapacity for large enterprises is in the negative numbers.

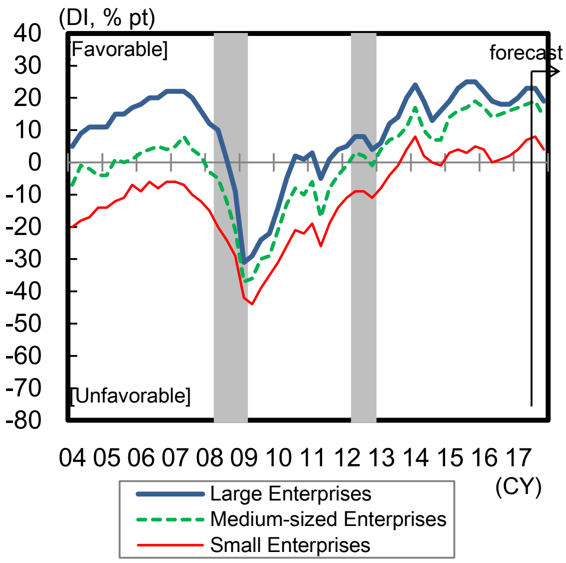
Labor market to see further tightening

Employment conditions DI for corporations of all sizes in both manufacturing and non-manufacturing declined (supply/demand becoming tighter). The sense of a shortage of manpower is increasing amongst corporations. Employment conditions DI are expected to decline further in the future for both manufacturing and non-manufacturing centering on small and medium-size corporations, with the condition of the labor market expected to become increasingly tight.

Some industries are seen as facing difficulties in acquiring the employees they need in the near future. These industries will likely be required to improve conditions for their employees, either in the form of accepting more as regular employees or by increasing wages. This will require investment in acquiring personnel as well as investment in labor-saving systems. If corporations are unable to sufficiently carry out price pass-through regarding their sales prices to cover the increase in personnel expenses, it could become a negative factor for corporate earnings, especially for small business and labor-intensive industries. It is necessary for the government to work on means of handling this situation, such as easing of regulatory restrictions to promote improvements in productivity.

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					
	Jun. 2017 Survey		Sep. 2017 Survey				Jun. 2016 Survey		Sep. 2017 Survey			
	Actual result	Forecast	Actual result	Changes	Forecast	Changes	Actual result	Forecast	Actual result	Changes	Forecast	Changes
Manufacturing	17	15	22	5	19	-3	7	6	10	3	8	-2
Textiles	3	0	6	3	3	-3	-20	-25	-22	-2	-25	-3
Lumber & Wood products	24	18	29	5	18	-11	-6	0	-1	5	-1	0
Pulp & Paper	7	-3	10	3	3	-7	-17	-9	-7	10	-8	-1
Chemicals	16	9	27	11	18	-9	12	8	18	6	10	-8
Petroleum & Coal products	25	0	31	6	19	-12	-6	-9	-5	1	-7	-2
Ceramics, Stone & Clay	24	9	22	-2	16	-6	7	7	6	-1	11	5
Iron & Steel	16	19	12	-4	14	2	19	23	30	11	32	2
Nonferrous metals	34	20	23	-11	14	-9	24	25	30	6	27	-3
Food & Beverages	21	15	18	-3	16	-2	12	13	11	-1	9	-2
Processed metals	10	10	8	-2	5	-3	20	17	20	0	14	-6
General-purpose machinery	29	29	35	6	33	-2	16	12	23	7	13	-10
Production machinery	23	28	36	13	38	2	15	11	22	7	13	-9
Business oriented machinery	15	25	30	15	30	0	9	14	17	8	18	1
Electrical machinery	16	23	27	11	26	-1	1	2	9	8	12	3
Shipbuilding & Heavy machinery, etc.	-11	-11	-14	-3	0	14	16	0	14	-2	11	-3
Motor vehicles	16	11	18	2	14	-4	19	14	30	11	22	-8
Basic materials	17	9	21	4	14	-7	3	4	8	5	5	-3
Processing	17	18	23	6	21	-2	9	7	14	5	11	-3
Nonmanufacturing	23	18	23	0	19	-4	7	2	8	1	4	-4
Construction	48	40	48	0	35	-13	16	7	17	1	9	-8
Real estate	35	28	35	0	30	-5	14	11	14	0	12	-2
Goods rental & Leasing	17	20	15	-2	18	3	18	14	20	2	16	-4
Wholesaling	13	9	21	8	15	-6	0	-4	0	0	-2	-2
Retailing	10	11	8	-2	13	5	-9	-8	-5	4	-4	1
Transport & Postal activities	19	8	18	-1	11	-7	7	3	8	1	4	-4
Communications	25	19	19	-6	19	0	24	21	23	-1	26	3
Information services	24	23	27	3	20	-7	17	14	17	0	12	-5
Electric & Gas utilities	-3	-3	3	6	5	2	17	13	18	1	12	-6
Services for businesses	33	31	40	7	33	-7	11	6	12	1	7	-5
Services for individuals	35	25	35	0	30	-5	3	1	7	4	3	-4
Accommodations, Eating & Drinking services	13	11	6	-7	7	1	4	-5	0	-4	-2	-2
All industries	20	16	23	3	19	-4	7	4	9	2	6	-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)

		FY2016	FY2017 (Forecast)	Revision rate
Large Enterprises	Manufacturing	-2.9	2.7	0.3
	Domestic Sales	-1.5	2.9	0.0
	Exports	-6.1	2.2	1.0
	Nonmanufacturing	-3.8	2.8	0.2
	All industries	-3.4	2.8	0.2
Medium-sized Enterprises	Manufacturing	0.1	3.4	0.6
	Nonmanufacturing	0.9	2.4	-0.1
	All industries	0.7	2.6	0.0
Small Enterprises	Manufacturing	-0.3	1.8	0.0
	Nonmanufacturing	0.8	0.8	0.6
	All industries	0.6	1.0	0.5
All Enterprises	Manufacturing	-2.0	2.6	0.3
	Nonmanufacturing	-1.2	2.1	0.2
	All industries	-1.5	2.2	0.3

Current Profits (Year-to-year % change)

		FY2016	FY2017 (Forecast)	Revision rate
Large Enterprises	Manufacturing	-0.5	4.7	8.3
	Basic materials	8.1	7.1	5.5
	Processing	-3.9	3.7	9.7
	Nonmanufacturing	5.7	-1.6	1.2
	All industries	2.8	1.3	4.5
Medium-sized Enterprises	Manufacturing	0.5	0.8	1.9
	Nonmanufacturing	9.2	-3.6	2.4
	All industries	6.4	-2.3	2.2
Small Enterprises	Manufacturing	16.4	-3.0	0.3
	Nonmanufacturing	5.8	-8.6	1.0
	All industries	8.3	-7.2	0.8
All Enterprises	Manufacturing	1.6	3.2	6.5
	Nonmanufacturing	6.4	-3.7	1.3
	All industries	4.4	-1.0	3.4

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

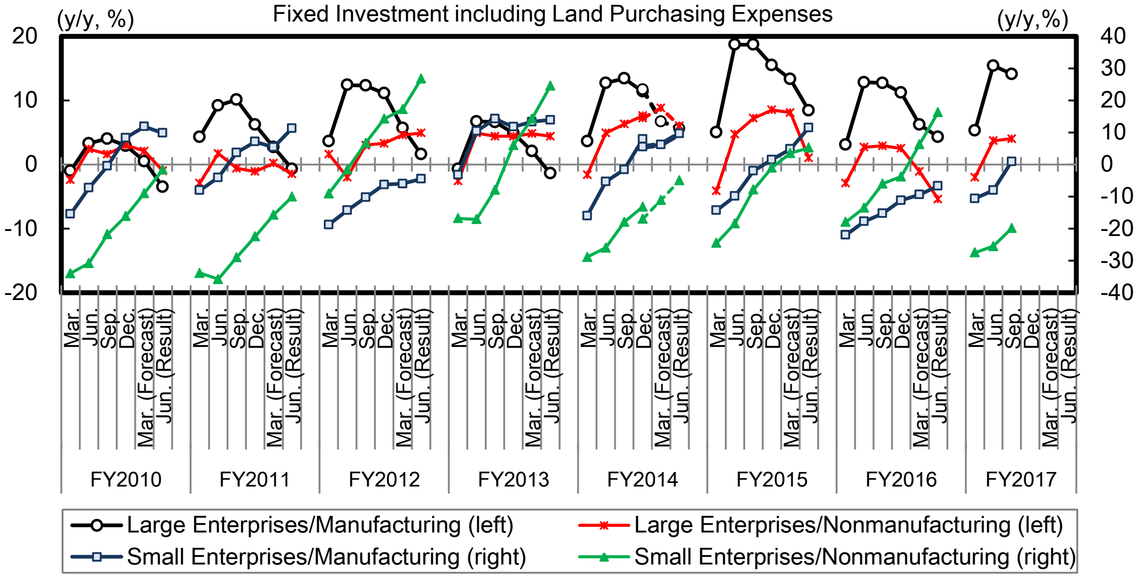
Developments of Fixed Investment including Land Purchasing Expenses (excl. software investment) — Chart 3

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

		FY2016	FY2017 (Forecast)	Revision rate
Large Enterprises	Manufacturing	4.3	14.1	-1.2
	Nonmanufacturing	-5.4	4.0	0.3
	All industries	-2.1	7.7	-0.3
Medium-sized Enterprises	Manufacturing	6.3	13.2	2.1
	Nonmanufacturing	-3.1	19.6	3.2
	All industries	0.2	17.2	2.8
Small Enterprises	Manufacturing	-6.7	0.9	9.8
	Nonmanufacturing	16.3	-19.9	7.6
	All industries	8.8	-14.1	8.3
All Enterprises	Manufacturing	2.6	11.7	0.9
	Nonmanufacturing	-0.7	0.8	2.1
	All industries	0.4	4.6	1.7

Software Investment (Year-to-year % change)

		FY2016	FY2017 (Forecast)	Revision rate
Large Enterprises	Manufacturing	-5.3	4.5	-0.5
	Nonmanufacturing	8.8	5.6	0.7
	All industries	3.7	5.3	0.3
Medium-sized Enterprises	Manufacturing	-5.4	35.4	0.3
	Nonmanufacturing	-9.5	9.5	3.1
	All industries	-8.9	13.4	2.6
Small Enterprises	Manufacturing	-2.0	22.9	-5.8
	Nonmanufacturing	11.3	22.3	3.3
	All industries	7.3	22.4	0.6
All Enterprises	Manufacturing	-5.1	7.9	-0.9
	Nonmanufacturing	5.6	7.5	1.3
	All industries	2.1	7.6	0.6



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.