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BOJ June 2017 Tankan Survey

Business sentiment experiences pronounced improvement as expected, but influence on policy limited

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Summary

- In the BOJ June 2017 Tankan survey of corporate sentiment, the current trend in business sentiment for all industries and corporations of all sizes has improved noticeably. 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. Our outlook for the Japanese economy sees a gradual improvement, and the June BOJ Tankan reflects that.

- The business conditions DI for large manufacturers grew to +17%pt in comparison with last survey's +12%pt, while at the same time exceeding market consensus at +15%pt. Overseas economies continue to recover, and the positive effects of a weaker yen since November 2016 continue to be felt, bringing the third consecutive quarter in improvement. Business conditions DI for large non-manufacturing industries improved at +23%pt in comparison to the previous survey at +20%pt, coming in right at the level expected by market consensus (+23%pt).

- The FY 2017 capex projection for all enterprises in all industries (incl. investment in properties but excl. that in software; all industries, all companies) is +2.9% y/y, falling below market consensus (+3.9%). much focus was placed on the revision in research & development investment, which is a category whose publication just began as of the last survey. This amount was revised downwards slightly by large enterprises in all industries. Therefore future revision patterns should continue to be approached cautiously.

- Employment conditions DI for manufacturing are expected to mark time, while non-manufacturing expects a small amount of growth (an easing of supply/demand stringency). However, in terms of level, employment very much retains its former condition of experiencing an excessive shortage of labor. This indicates that corporations still experience a major shortage of manpower. Employment conditions DI are expected to decline further in the future for enterprises of all sizes in all industries, with the condition of the labor market expected to remain tight.

Business sentiment improves for all enterprises in both manufacturing and non-manufacturing

In the BOJ June 2017 Tankan survey of corporate sentiment, the current trend in business sentiment for all industries and corporations of all sizes has improved noticeably. 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. Our current view for the Japanese economy sees a gradual improvement, and the June BOJ Tankan reflects that. With results being more or less what was expected, no major influence is seen on economic or monetary policy.

The business conditions DI for large manufacturers grew to +17%pt in comparison with last survey's +12%pt, while at the same time exceeding market consensus at +15%pt. Overseas economies continue to recover, and the positive effects of a weaker yen since November 2016 continue to be felt, bringing the third consecutive quarter in improvement. Worthy of note is the fact that both the materials and processing industries showed improvement.

The basic materials industries improved at +17%pt in comparison to the previous survey's +12%pt, making this the fifth consecutive quarter of improvement. As for performance of individual industries, all industries with the exception of lumber and wood products saw improvements, and improvement spread wider across these industries. Profits improved due to the rise in in materials prices (sales price), with improvement especially notable for ceramics, stone & clay, iron & steel, chemicals, and non-ferrous metals. As for iron & steel, this industry is gradually shaking off the negative influence of excessive supply from Chinese manufacturers and the high price of coking coal. Petroleum & coal products and pulp & paper appear to have done well due partly to the rebound from the previous report's weak results.

The processing industries saw improvement in business sentiment for the fourth consecutive quarter at +17%pt in comparison to the previous survey's +12%pt. As for performance by industry, business conditions improved notably for general-purpose machinery, production machinery, business oriented machinery and electrical machinery. As for electrical machinery, yen depreciation and the underlying strength of electronic parts exports to Asia were thought to have been a plus. However, electronic parts exports appear to have weakened recently, a fact in regard to which we urge caution. As for general-purpose machinery, production machinery, and business oriented machinery, both exports and production are making a comeback, and this appears to have provided a lift.

On the other hand, business sentiment worsened for motor vehicles for the first time in four quarters, though overall they were marking time. While the continued weak yen effect improved sentiment somewhat, exports to the US were sluggish, and this caused a drag on performance.

Business conditions DI for large non-manufacturing industries improved at +23%pt in comparison to the previous survey at +20%pt, coming in right at the level expected by market consensus (+23%pt). In addition to a comeback for consumption, inbound demand was also favorable, providing a tailwind for performance, which chalked up the second consecutive quarter of improvements.

Looking at performance by industry, improvement in business conditions DI was seen in retailing and services for individuals due to the comeback in consumption and the growth trend in the number of foreign tourists visiting Japan. Construction also took a step up in improvement due to favorable demand. This industry was already maintaining a high level of performance, but the recent favorability of orders took it that much further. Real estate marked time, but maintained its previous high level, with a business environment that continues to be favorable. On the other hand, business conditions DI worsened for communications, information services, and accommodations, eating & drinking services. Although the effects of IT investment and the comeback in consumption are positive factors for these industries, performance appears to have been taking a breather recently. As for accommodations, eating & drinking services, the effects of the shortage of labor are being felt. Meanwhile, electric & gas utilities also did poorly due to the drag on profits caused by the increase of energy costs and the time lag in gaining the benefits of price pass-through.

Cautious stance expected to continue in future, 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 +15%pt (a worsening of -2%pt in comparison to the current survey), while large enterprises in the non-manufacturing sector are seen at +18%pt (worsening by -5%pt in comparison with the current survey). This shows that corporations remain cautious regarding the future. This is due to 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.

Domestic & overseas supply and demand improves

Taking a look at supply and demand conditions DI in the areas of domestic products and services for large enterprises, we see that improvements were seen in both manufacturing and non-manufacturing. As for manufacturing, the recovery trend continues, with improvements being experienced for the third consecutive quarter. Growth in exports due to the recovery in the overseas economy, as well as a comeback for domestic demand are thought to have brought positive influence.

As for large manufacturers' supply and demand conditions DI for overseas products and services, there was an improvement at -2%pt in comparison to the previous survey (-4%pt). This category has improved notably for the fifth consecutive quarter, reflecting improvement in the overseas economy.

Meanwhile, regarding price conditions, the output price conditions DI for both large manufacturing and non-manufacturing enterprises grew due to the increase in the price of crude oil since the end of last year, and the progressively weak yen, which has helped price pass-through conditions. Meanwhile, input price conditions DI declined as a result of recent movements in the price of crude oil and foreign exchange rates. This meant an improvement in terms of trade (output price conditions DI – input price conditions DI), which had recently been in a worsening trend. The effects of the major collapse in the price of crude oil since June this year have not yet been sufficiently reflected in the Tankan survey since the survey was being carried out just at the time that this new trend appeared.

Large manufacturers' FY2017 current profit projections expected to rebound

Sales projections of large enterprises (all industries) for FY2017 were revised upwards by +2.5% y/y, reflecting the effects of the rebound from the decline in earnings experienced during FY2016. The effect of sales growth on growth in profits is definitely a bright spot. Current profit projections were also revised upwards significantly at +7.8%. Most notable is the fact that both the manufacturing and non-manufacturing industries received major upward revisions due to the increase in exports backed by the recovery in the overseas economy, and the comeback for domestic demand. The year-to-year change for current profit was revised downward as a result of FY2016 current profit having been revised upwards significantly. The assumed exchange rate for the first half of FY2017 for large manufacturers is 108.36 yen to the dollar, more or less unchanged from the previous survey's 108.45 yen to the dollar. The current yen rate shows a significantly weaker yen than the assumed rate. Hence the current profit projections of export-driven manufacturers for the first half of FY2017 will likely be higher than on the June BOJ Tankan.

FY2017 research & development investment revised downwards slightly

The FY 2017 capex projection for all enterprises in all industries (incl. investment in properties but excl. that in software and R&D; all industries, all companies) is +2.9% y/y, falling below market consensus (+3.9%). Looking at the performance of large enterprises by industry, we see that capex projections of manufacturers for FY2017 is +15.4%, while large enterprises in non-manufacturing are at +3.7%. This is more or less along the lines of past revisions. As for FY2016, it should be noted that the non-manufacturing capex projection was revised downwards. Moreover, much focus was placed on the revision in research & development investment, which is a category whose publication just began as of the last survey. This amount was revised downwards slightly by large enterprises in all industries. Therefore future revision patterns should continue to be monitored closely.

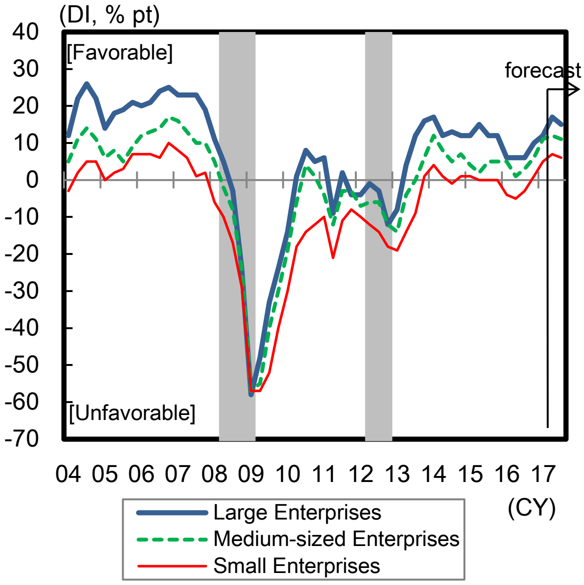
Looking at production capacity DI for large manufacturers, we see that it was at -1%pt in comparison to the previous survey's (+1%) (this represents an improvement), while large non-manufacturers were at -1%pt, flat in comparison to the previous survey which was at -1%pt. Manufacturing shows a future projection of growth (representing a worsening), while non-manufacturing is expected to decline (an improvement). Overall, the overcapacity projection for large enterprises was marking time.

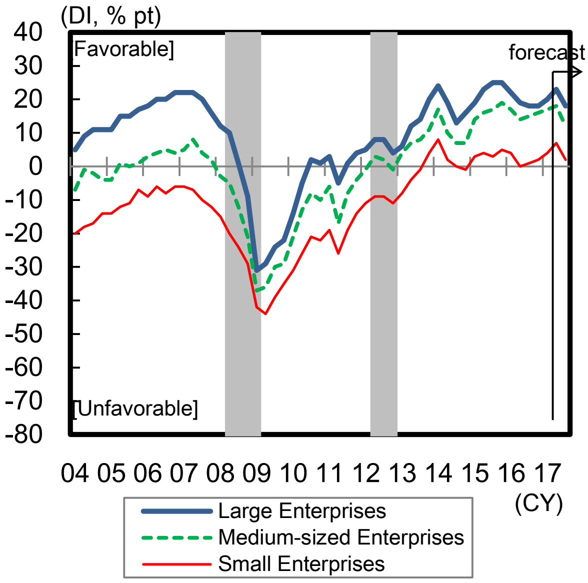
Labor market to see further tightening

Employment conditions DI for manufacturing are expected to mark time, while non-manufacturing expects a small amount of growth (an easing of supply/demand stringency). However, in terms of level, employment very much retains its former condition of experiencing an excessive shortage of labor. This indicates that corporations still experience a major shortage of manpower. Employment conditions DI are expected to decline further in the future for enterprises of all sizes in both manufacturing and non-manufacturing, with the condition of the labor market expected to remain tight.

Some industries are expected to face difficulties in acquiring the employees they need. 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 labor-intensive industries. This situation also requires careful monitoring in the future.

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					
	Mar. 2017 Survey		June 2017 Survey				Mar. 2016 Survey		June 2017 Survey			
	Actual result	Forecast	Actual result	Changes	Forecast	Changes	Actual result	Forecast	Actual result	Changes	Forecast	Changes
Manufacturing	12	11	17	5	15	-2	5	0	7	2	6	-1
Textiles	0	-3	3	3	0	-3	-27	-29	-20	7	-25	-5
Lumber & Wood products	47	24	24	-23	18	-6	0	-9	-6	-6	0	6
Pulp & Paper	3	-3	7	4	-3	-10	-19	-11	-17	2	-9	8
Chemicals	13	15	16	3	9	-7	11	-2	12	1	8	-4
Petroleum & Coal products	6	12	25	19	0	-25	-4	-7	-6	-2	-9	-3
Ceramics, Stone & Clay	13	18	24	11	9	-15	4	-6	7	3	7	0
Iron & Steel	0	7	16	16	19	3	20	14	19	-1	23	4
Nonferrous metals	23	20	34	11	20	-14	20	19	24	4	25	1
Food & Beverages	20	14	21	1	15	-6	3	6	12	9	13	1
Processed metals	15	7	10	-5	10	0	13	10	20	7	17	-3
General-purpose machinery	25	20	29	4	29	0	5	7	16	11	12	-4
Production machinery	17	21	23	6	28	5	16	8	15	-1	11	-4
Business oriented machinery	4	18	15	11	25	10	6	7	9	3	14	5
Electrical machinery	10	13	16	6	23	7	5	1	1	-4	2	1
Shipbuilding & Heavy machinery, etc.	-21	-18	-11	10	-11	0	10	-1	16	6	0	-16
Motor vehicles	18	9	16	-2	11	-5	23	13	19	-4	14	-5
Basic materials	12	12	17	5	9	-8	2	-4	3	1	4	1
Processing	12	12	17	5	18	1	7	3	9	2	7	-2
Nonmanufacturing	20	16	23	3	18	-5	4	-1	7	3	2	-5
Construction	43	30	48	5	40	-8	15	0	16	1	7	-9
Real estate	35	28	35	0	28	-7	15	10	14	-1	11	-3
Goods rental & Leasing	14	11	17	3	20	3	17	9	18	1	14	-4
Wholesaling	11	7	13	2	9	-4	-6	-6	0	6	-4	-4
Retailing	5	11	10	5	11	1	-8	-8	-9	-1	-8	1
Transport & Postal activities	12	6	19	7	8	-11	5	-3	7	2	3	-4
Communications	31	31	25	-6	19	-6	21	24	24	3	21	-3
Information services	28	22	24	-4	23	-1	19	14	17	-2	14	-3
Electric & Gas utilities	5	-3	-3	-8	-3	0	10	10	17	7	13	-4
Services for businesses	30	23	33	3	31	-2	7	3	11	4	6	-5
Services for individuals	30	27	35	5	25	-10	-2	-5	3	5	1	-2
Accommodations, Eating & Drinking services	17	11	13	-4	11	-2	-6	-6	4	10	-5	-9
All industries	16	14	20	4	16	-4	5	-1	7	2	4	-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	2.4	1.4
	Domestic Sales	-1.5	2.9	2.0
	Exports	-6.1	1.1	0.1
	Nonmanufacturing	-3.8	2.6	2.5
	All industries	-3.4	2.5	2.1
Medium-sized Enterprises	Manufacturing	0.1	2.8	0.7
	Nonmanufacturing	0.9	2.6	0.5
	All industries	0.7	2.6	0.5
Small Enterprises	Manufacturing	-0.3	1.8	1.0
	Nonmanufacturing	0.8	0.2	1.5
	All industries	0.6	0.5	1.4
All Enterprises	Manufacturing	-2.0	2.3	1.2
	Nonmanufacturing	-1.2	1.8	1.7
	All industries	-1.5	2.0	1.5

Current Profits (Year-to-year % change)

		FY2016	FY2017 (Forecast)	Revision rate
Large Enterprises	Manufacturing	-0.5	-3.3	8.9
	Basic materials	8.1	1.5	14.3
	Processing	-3.9	-5.5	6.5
	Nonmanufacturing	5.7	-2.7	7.0
	All industries	2.8	-3.0	7.8
Medium-sized Enterprises	Manufacturing	0.5	-1.1	-0.5
	Nonmanufacturing	9.2	-5.9	0.4
	All industries	6.4	-4.4	0.1
Small Enterprises	Manufacturing	16.4	-3.4	1.9
	Nonmanufacturing	5.8	-9.5	3.0
	All industries	8.3	-8.0	2.7
All Enterprises	Manufacturing	1.6	-3.1	6.7
	Nonmanufacturing	6.4	-5.0	4.7
	All industries	4.4	-4.2	5.5

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

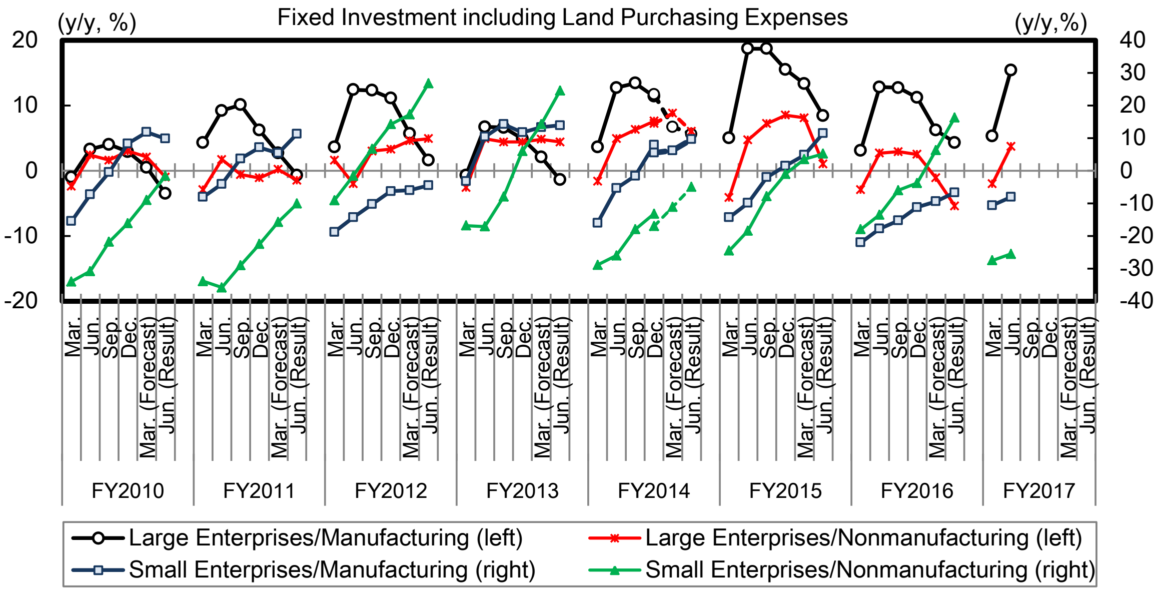
Developments of Fixed Investment including Land Purchasing Expenses (excl. software investment) — Chart 3

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

		FY2016	FY2017 (Forecast)	Revision rate
Large Enterprises	Manufacturing	4.3	15.4	7.6
	Nonmanufacturing	-5.4	3.7	1.2
	All industries	-2.1	8.0	3.6
Medium-sized Enterprises	Manufacturing	6.3	10.8	2.5
	Nonmanufacturing	-3.1	15.9	1.6
	All industries	0.2	14.0	1.9
Small Enterprises	Manufacturing	-6.7	-8.1	6.0
	Nonmanufacturing	16.3	-25.5	12.4
	All industries	8.8	-20.6	10.2
All Enterprises	Manufacturing	2.6	10.7	6.5
	Nonmanufacturing	-0.7	-1.2	3.1
	All industries	0.4	2.9	4.3

Software Investment (Year-to-year % change)

		FY2016	FY2017 (Forecast)	Revision rate
Large Enterprises	Manufacturing	-5.3	5.1	-2.3
	Nonmanufacturing	8.8	4.9	7.0
	All industries	3.7	5.0	3.8
Medium-sized Enterprises	Manufacturing	-5.4	35.0	9.8
	Nonmanufacturing	-9.5	6.2	1.8
	All industries	-8.9	10.6	3.2
Small Enterprises	Manufacturing	-2.0	30.4	5.1
	Nonmanufacturing	11.3	18.4	4.0
	All industries	7.3	21.7	4.3
All Enterprises	Manufacturing	-5.1	8.8	-0.8
	Nonmanufacturing	5.6	6.2	5.9
	All industries	2.1	7.0	3.8



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.