

Daiwa's Economic View

June Tankan: Little downward pressure on firms, prolonged uncertainty a concern

- Unexpected improvement for manufacturers; limited negative impact on corporate sentiment
- Implies steady progress toward BOJ's 2% price stability target
- Should make BOJ more confident about raising rates, but likely to stay cautious given prolonged uncertainty

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Focus in June Tankan: Impact of tariffs, stickiness of inflation

The Bank of Japan (BOJ) released the results of its June Tankan survey on 1 July. At his regular June press conference, Governor Kazuo Ueda noted that while a growing number of sentiment-related indicators were unfavorable, hard data was upbeat. However, we note that the BOJ Tankan was the most important soft data indicator. For the latest survey, the response collection reference date was 12 June.

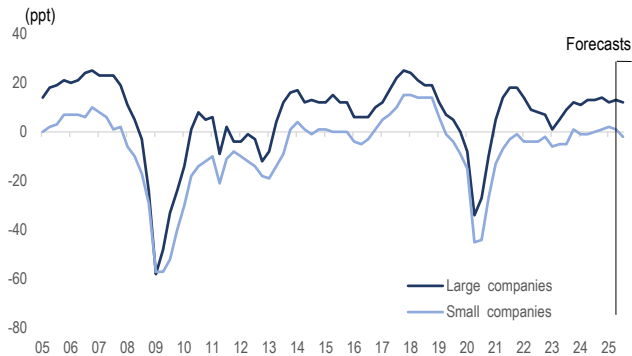
We focus in today's Tankan release on (1) the impact of US tariff policy on corporate activity, and (2) how upbeat consumer price data is affecting companies' inflation expectations and their desire to pass on higher costs. Companies did not appear to be fully factoring in the impact of tariffs in the previous survey, and the latest release is therefore important in gauging the impact of the Trump administration's tariff policies on corporate sentiment.

Tariff policy impact: Unexpected improvement for manufacturers; limited negative impact on corporate sentiment

The business conditions DI in the June Tankan was up to +13 (from +12 in March) for large manufacturers and down to +34 (from +35) for large non-manufacturers, indicating an unexpected improvement at the manufacturers that will be affected most by tariffs. In contrast, the DI for small manufacturers worsened to +1 (from +2) and for non-manufacturers it fell to +15 (from +16).

Among large manufacturers, the DI for the auto sector worsened to +8 (from +13 in the previous survey), but remained at a favorable level. The DI improved to -3 (from -18) for iron & steel and to +16 (from +15) for nonferrous metals, indicating a limited negative impact on corporate sentiment in categories subject to high Trump tariffs. The improvement in manufacturing industries came as a surprise given the stronger yen and slower Chinese economy compared with the previous survey. In the basic materials sector, we think business conditions improved as raw material prices settled down. However, we think the worsening sentiment among large non-manufacturers in goods leasing, real estate, and retail reflected sustained high raw material costs, prolonged inflation (which is making consumers more cost-conscious), and worsening labor shortages.

Large manufacturers' forecasts for the business conditions DI worsened slightly to +12 (down 1 from the previous survey), including +7 (-1) for autos, but the negative impact was limited. The latest Tankan implies no major impact on corporate sentiment, supporting the BOJ's policy of continuing to raise interest rates.

Chart 1: Business Conditions DI (manufacturing)


Source: BOJ; compiled by Daiwa.

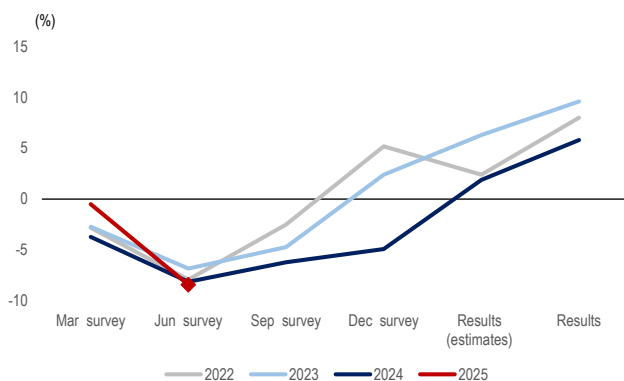
Chart 2: Business Conditions DI (non-manufacturing)


Source: BOJ; compiled by Daiwa.

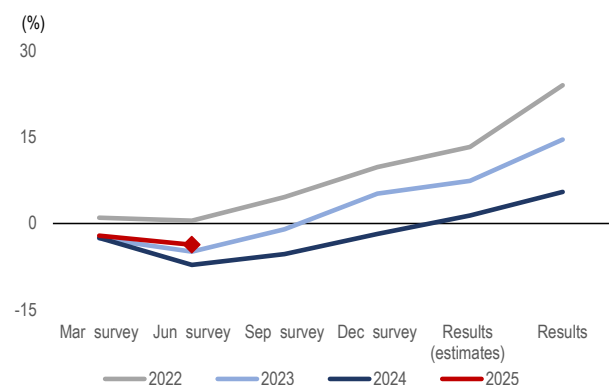
FY25 recurring profit plans (all enterprises) were -8.4% y/y (-0.5% in the previous survey) for manufacturers and -3.7% (-2.1%) for non-manufacturers. Companies typically revise down recurring profit forecasts in the June survey, but the cuts were larger than usual. We would also note that some firms' recurring profit forecasts are provisional given the considerable uncertainty about US tariff policy. We think these firms face a major impact from tariff policy and see the potential for further downward revisions.

Including overseas operations, FY25 consolidated recurring profit forecasts are -4.8% y/y ($+1.9\%$ in previous survey) for manufacturers and -4.9% (-0.9%) for non-manufacturers. The environment for corporate earnings (including overseas subsidiaries) remains unfavorable, mainly for manufacturers.

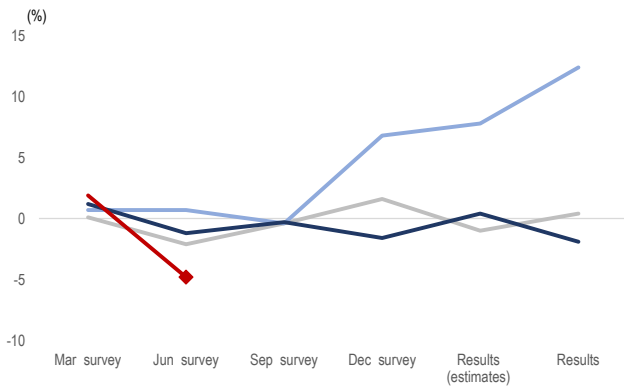
Our simulation using the Financial Statements Statistics of Corporations based on how much companies reduced FY25 recurring profit forecasts in the June survey suggests that while the labor share of income is set to rise sharply in FY25, it remains below pre-pandemic levels. As noted, we need to pay attention to further downward revisions to recurring profit plans, but at this point we continue to think that historically high corporate earnings will support companies, meaning that on a macro level they should be able to secure the funding for wage hikes.

Chart 3: Recurring Profit Plans (all-size manufacturers)


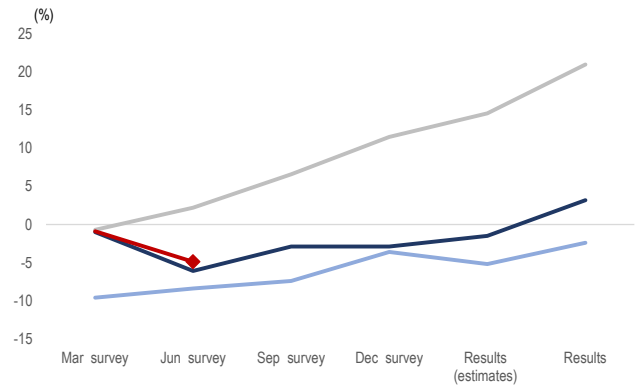
Source: BOJ; compiled by Daiwa.

Chart 4: Recurring Profit Plans (all-size non-manufacturers)


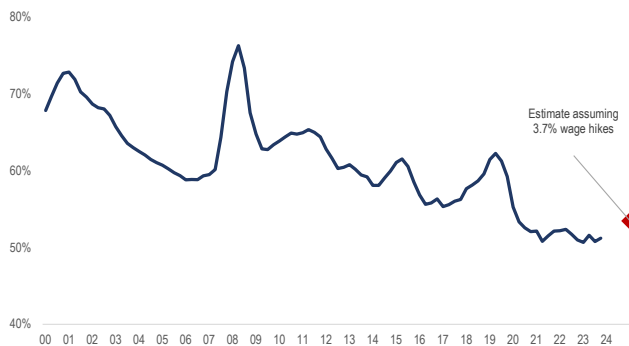
Source: BOJ; compiled by Daiwa.

Chart 5: Consolidated Recurring Profit (all-size manufacturers)


Source: BOJ; compiled by Daiwa.

Chart 6: Consolidated Recurring Profit (all-size non-manufacturers)


Source: BOJ; compiled by Daiwa.

Chart 7: Labor Share Estimate (all-size manufacturers)


Source: BOJ; compiled by Daiwa.

Notes: (1) Labor share is calculated as "(personnel expense) ÷ (depreciation + recurring profit + personnel expense)."

(2) We assume that labor costs increase by 3.71%, in line with the increase in base pay agreed in the 2025 spring labor negotiations (as of sixth round of responses).

Chart 8: Labor Share Estimate (all-size non-manufacturers)

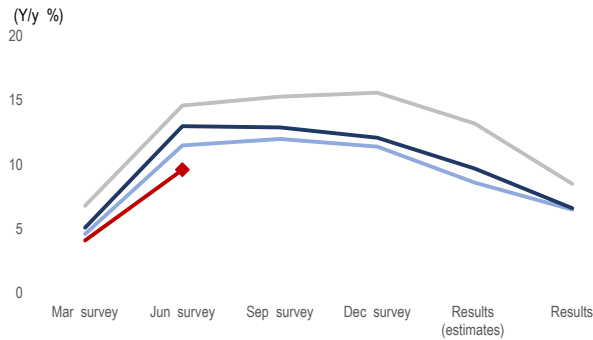

Source: BOJ; compiled by Daiwa.

Capex plans: No major changes, but companies could slow spending

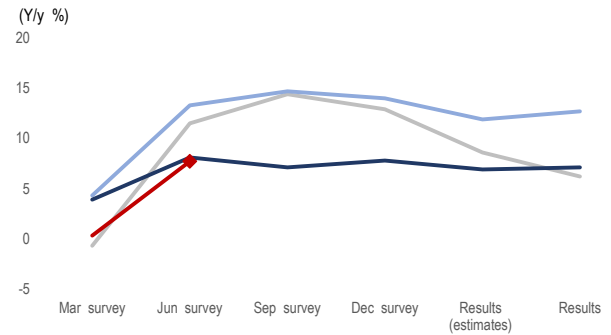
FY25 capex plans (excluding land purchases, including software and R&D) were revised up from +4.1% y/y to +9.6% for manufacturers and from +0.3% to +7.7% for non-manufacturers. Companies typically revise up capex plans from summer through autumn; the June survey showed a similar trend, with no signs of an inflection.

The industrial total supply tables (domestic shipments + imports) in the Indices of Industrial Production released on 30 June also confirmed that companies are tending to curb capex, with the total supply of capital goods (excluding transportation equipment) down 3.5% in Apr-May vs. Jan-Mar.

Despite positives such as structural labor shortages and digital transformation (DX) demand, there are numerous factors that could cause companies to put off capex, including downward pressure on corporate earnings, higher investment costs, and rising uncertainty (including the potential for supply chain disruptions). We will be watching for any major changes in corporate spending trends.

Chart 9: Fixed Investment Plans (all-size manufacturers)


Source: BOJ; compiled by Daiwa.

Chart 10: Fixed Investment Plans (all-size non-manufacturers)


Source: BOJ; compiled by Daiwa.

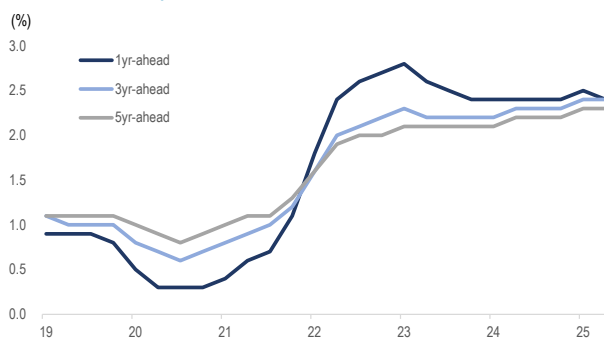
Inflation: Steady progress toward BOJ's 2% price stability target

The Inflation Outlook of Enterprises (all enterprises, all industries), a key focus for the BOJ, remained high at +2.3% five years out (unchanged from the March survey). We think the drivers of long-term inflation expectations are broader-based cost pass-throughs, wage hikes from the 2025 spring labor negotiations, and prolonged inflation.

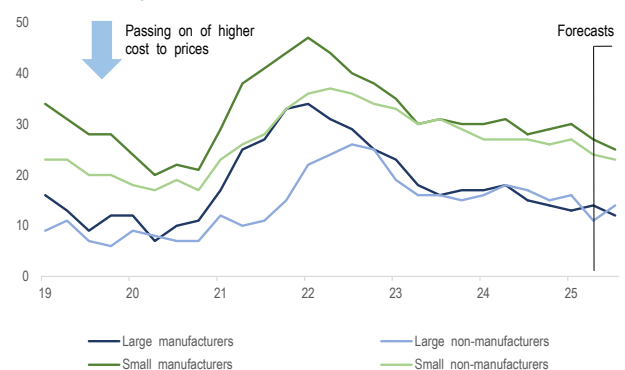
However, the overall inflation outlook (all enterprises, all industries) one year ahead slowed slightly to +2.4% (from +2.5% in the March survey). Short-term inflation expectations fell particularly at small enterprises, which we think are factoring in lower raw material costs.

Both the input and output price DIs for large manufacturers have recently declined. Meanwhile, the input price DI for large non-manufacturers fell but the output price DI rose. The output price DI for large manufacturers fell less than the input price DI, confirming a certain degree of price pass-throughs amid the downtrend of raw material prices. The recent decline in the input price DI for small enterprises also contrasts with the lack of change in the output price DI, signaling firms' continued appetite for passing through rising costs.

On the inflation front, companies remain eager to pass on previous cost increases even with input prices now falling, and long-term inflation expectations are also stable, implying steady progress toward the BOJ's 2% price stability target, with no excessive pickup or slowdown in pace.

Chart 11: Outlook for General Prices (all company sizes, all industries)


Source: BOJ; compiled by Daiwa.

Chart 12: Input Price DI - Output Price DI (Pseudo Terms of Trade)


Source: BOJ; compiled by Daiwa.

Should make BOJ more confident about raising rates, but likely to stay cautious given prolonged uncertainty

In big-picture terms, inflation is on track to achieve the BOJ's 2% price stability target, and corporate sentiment and capex trends imply a limited shock from tariffs. The downward pressure on corporate earnings is also small enough that we would still expect wage hikes from the 2026 spring labor negotiations. We expect the above to make the BOJ more confident about raising interest rates.

However, Minister for Economic Revitalization Ryosei Akazawa returned home from the seventh round of US-Japan negotiations on tariffs (a major source of uncertainty) having failed to schedule a meeting with Treasury Secretary Scott Bessent. Mr. Akazawa has positioned 9 July (the end of the current pause on the US's "reciprocal" tariffs) as a critical juncture in negotiations, and we think an eighth ministerial-level meeting will likely be held by then. However, we think an early agreement is unlikely given the two countries' diverging stances.

This is likely to prolong the uncertainty created by US tariff policy. Lingering uncertainty could further depress corporate sentiment and make curbs on capex and other spending more likely, exacerbating their negative impact.

BOJ Governor Kazuo Ueda noted at his regular June press conference that while the central bank can only watch progress with trade negotiations from the sidelines, further delays mean that it has to keep treating trade policy as a question mark. We therefore think the BOJ will need to remain cautious at least until visibility improves on the outcome of US-Japan negotiations. It will likely need time to assess the downside risks to the economy.

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