

# The current situations and issues of Japanese enterprises seen in the BOJ's TANKAN.

Hot Topics

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## Outlines

In 2020, the world economy has changed significantly due to the spread of COVID-19. The Japanese enterprises were also greatly affected. In April, the government announced the emergency declaration and made the economic activities partially stopped. While it is true that the economy has cooled down rapidly as a whole, it is also important to note that not all the enterprises have stopped activities. For example, industries that support daily life under COVID-19 continued to operate. Based on the result of “Tankan”, Short-term Economic Survey of Enterprises in Japan released by the Bank of Japan (BOJ), we analyze the current situations and issues of Japanese enterprises.

The survey in June was conducted during the period from May 28 to June 30, reflecting the situation after the full lifting of the emergency declaration on May 25.

## The business condition in an uneven manner

The Chart 1 summarizes business sentiment by industry and enterprise size in the BOJ's survey. The business conditions diffusion index (DI) is calculated by subtracting the percentage of enterprises that answered "unfavorable" from the percentage of enterprises that answered "favorable." If the DI is positive, it means that relatively many enterprises have favorable business conditions.

About the current business conditions, there are three answer options; favorable, not so favorable, and unfavorable. If the composition ratio is, for example, assumed as follows (total is 100%),

“favorable” 30%

“not so favorable” 50%, and

“unfavorable” 20%,

the business condition DI is calculated as 10 (=“favorable” 30% — “unfavorable” 20%).

Chart(1) Business condition DI (Tankan)

(DI, "favorable" minus "unfavorable", %points)

No.	Industry	Large Enterprises			Small Enterprises		
		2020			2020		
		Mar.	Jun.	Forecast	Mar.	Mar.	Forecast
1	All industries	0	-26	-21	-7	-33	-38
2	Manufacturing	-8	-34	-27	-15	-45	-47
3	Textiles	-17	-38	-27	-46	-72	-73
4	Lumber & Wood products	0	-53	-47	-13	-39	-57
5	Pulp & Paper	4	-33	-12	-20	-50	-64
6	Chemicals	-6	-19	-17	-5	-28	-36
7	Petroleum & Coal products	-18	-32	-6	-4	-17	-17
8	Ceramics, Stone & Clay	14	-8	-17	-3	-21	-21
9	Iron & Steel	-15	-58	-57	-34	-64	-64
10	Nonferrous metals	-26	-39	-36	-29	-70	-60
11	Food & Beverages	5	-8	-9	-19	-43	-30
12	Processed metals	-19	-25	-28	-17	-44	-53
13	General-purpose machinery	0	-26	-28	2	-25	-48
14	Production machinery	-11	-37	-29	-17	-53	-59
15	Business oriented machinery	-6	-29	-16	-14	-40	-37
16	Electrical machinery	-3	-28	-18	-9	-31	-45
17	Shipbuilding, Heavy machinery	-29	-46	-54	3	-24	-38
18	Motor vehicles	-17	-72	-51	-9	-79	-52
19	Other manufacturing	-17	-41	-40	-13	-52	-50
20	Nonmanufacturing	8	-17	-14	-1	-26	-33
21	Construction	36	15	5	18	5	-13
22	Real estate	32	-12	-2	9	-12	-22
23	Goods rental & Leasing	29	7	-3	17	-29	-31
24	Wholesaling	-7	-27	-24	-10	-38	-47
25	Retailing	-7	2	-5	-20	-38	-41
26	Transport & Postal activities	-7	-43	-23	-10	-38	-38
27	Communications	14	8	8	9	-3	9
28	Information services	45	20	2	22	5	-17
29	Electric & Gas utilities	3	-22	-7	16	8	0
30	Services for businesses	35	8	11	11	-18	-24
31	Services for individuals	-6	-70	-46	-14	-66	-52
32	Accommodations, Eating &	-59	-91	-77	-52	-87	-82

(Source: Bank of Japan)

The business conditions DI for large manufacturers marked minus 34, down 26 points from the previous survey in March, marking negative for the second consecutive quarter. The business conditions deteriorated due to the US-China trade war in 2019, and it further deteriorated due to the spread of the COVID-19. The COVID-19 expanded from China to Europe and the US. Lockdowns and restrictions on transports were enforced, and the exports from Japan decreased abruptly as the foreign demand disappeared.

By category, business confidence deteriorated significantly across the board for large manufacturing enterprises, including No. 4 Lumber & Wood products, No. 9 Iron & Steel, No. 10 Nonferrous metals, No. 17 Shipbuilding, Heavy machinery and other transportation equipment, and No. 18 Motor vehicles. In particular, for Motor vehicles, a sharp decline in demand from foreign countries and difficulty in procuring parts from China and other countries had a major impact on the decline in production. This made us recognize that the Motor vehicle industry highly depends on the parts imported from abroad. Motor vehicle industry's supply chain also affected a wide range of other industries, including Iron & Steel and Nonferrous metals. The business confidence collapsed in almost all the sectors of manufacturing industries.

The business conditions DI for large nonmanufacturing enterprises showed minus 17, 25 points worse than the previous survey. The decline was the largest ever.

The breakdown shows that businesses were restrained mainly in industries where they had a lot of contact with people, such as No.31 Service for individuals and No.32 Accommodation, Eating &

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Drinking services, which recorded a historical low.

On the other hand, there were some industries that maintained business confidence despite a decline from the previous year, such as No.21 Construction, No.23 Goods rental & Leasing, No.27 Communications, No.28 Information services and No.30 Services for businesses. Deterioration in business confidence was limited in those industries related to telecommunication systems that support remote working.

No.25 Retailing increased from minus 7 to +2. The results reminded us of the importance of industries that support daily life, such as supermarkets and drugstores, while sales fell sharply for those department stores that restricted ones' operations in urban area and those convenience stores located in tourist spots and office districts. And it appears that the consumers have acquired new behaviors, such as securing social distance. As can be seen above, the business confidence of the nonmanufacturing enterprises clearly shows the differences by each group of industries.

### **Outlook of the future**

Looking at the outlook over the next three months or so, the business conditions DI for large manufacturing enterprises is expected to recover slightly from the current minus 34 to minus 27, and for large nonmanufacturing enterprises from minus 17 to minus 14.

However, there are some industries where the situation is severer. For example, while the positive trend is maintained, No.21 Construction is expected to fall further from the current level of +15 to +5. No.32 Accommodation, Eating & Drinking services will recover from minus 91 to minus 77 but continue to be subdued at a very low level.

This is because the behavior of people has changed in the world "With COVID-19" and travel consumption such as by inbound foreign visitors cannot be expected for the time being. That's why the construction industry is discussing the revision of their construction plan. Under announcement of the emergency declaration, the construction was delayed due to the shortage of construction materials and human resources. And the capital investment plan may be changed partially or even totally because they cannot expect inbound consumption any more as before. There is also a need for a major overhaul of the Business Plan itself in terms of accommodation, food and beverage services and personal services. They are requested to widen the interior space of the stores, in order to secure social distancing, to expand takeout services and to run a kitchen car and so on.

Looking at the manufacturing by enterprise size, the business conditions DI for large enterprises is expected to recover slightly from the current minus 34 to minus 27. On the other hand, the trend of business confidence among small enterprises is expected to slightly deteriorate from minus 45 to minus 47, and the trend direction of near-future business confidence varies depending on the size of the enterprise.

We can think of the followings as the reason of the difference of business condition forecast by enterprise size.

In the world "With COVID-19", it is generally agreed that purchasing costs are on the rise for both large and small businesses since the DI of the Change in Input Prices will increase as shown in Chart 2. On the other hand, there is a difference in the cost imputation to overseas markets and sales prices. Small enterprises, unlike large enterprises, expect to see a further decline in sales prices.

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as shown in the further declining DI of the Change of Output Prices for them. As DI of the Oversea Supply & Demand Conditions for Products for small enterprises will keep the same negative level, the supply-demand balance in overseas markets becomes increasingly unfavorable.

Based on these results, it reveals that there are clearer difference in the outlook in the crisis phase due to the difference of the external environment and competitive power between large and small enterprises. And it is apparent that the situation varies greatly depending on the industry, even if the size of the enterprise is the same. Despite the unprecedented crisis, it is important to take into account the fact that the impact of COVID-19 varies depending on the industry and the size of enterprises.

**Chart (2) Input/ Output prices and Domestic/Oversea supply & demand**  
(%,points)

	Large Enterprises			Small Enterprises		
	Mar.	Jun.	Forecast	Mar.	Jun.	Forecast
Change in Input Prices, DI ("Rise" - "Fall")						
Manufacturing	5	-3	2	19	12	17
Nonmanufacturing	11	3	6	17	9	15
Change in Output Prices, DI ("Rise" - "Fall")						
Manufacturing	-7	-10	-8	-5	-8	-11
Nonmanufacturing	2	-5	-5	-1	-8	-9
Domestic Supply & Demand Conditions for Products and Services						
DI ("Excess demand" - "Excess Supply")						
Manufacturing	-14	-32	-29	-27	-45	-46
Nonmanufacturing	-9	-20	-19	-17	-29	-32
Overseas Supply & Demand Conditions for Products						
DI ("Excess demand" - "Excess Supply")						
Manufacturing	-14	-29	-25	-22	-42	-40
Nonmanufacturing	-14	-29	-24	-18	-37	-37

(Source: Bank of Japan)

### **"Not so favorable" business condition**

When the respondents will answer the questions about business confidence, three options are available: "Favorable" "Not so favorable" and "Unfavorable" as shown in Chart 3. The business conditions DI stated above are calculated as the difference between the ratio of "Favorable" and "Unfavorable." Using this DI, we can see the trend or direction as a whole (whether favorable or unfavorable), but it is difficult to assess the level or intensity of such direction (how seriously favorable or unfavorable).

The percentage of respondents who answered "Not so favorable" in the middle, both now and in the future, was around 50 for both large and small enterprises in manufacturing and nonmanufacturing. Of course, some industries such as small accommodation enterprises actually face the severe business conditions, but it is also important to note that business confidence is not declining uniformly across the board in Japan, but in an uneven manner in which nearly half of the companies feel "Not so favorable".

**Chart (3) Percentage share of the number of respondents choosing each alternative in business conditions**

(%, %points)

	Mar. survey		Jun. survey			
	Actual result		Actual result		Forecast	
	Large	Small	Large	Small	Large	Small
Manufacturing (DI)	-8	-15	-34	-45	-27	-47
1. Favorable	11	13	7	7	5	5
2. Not so favorable	70	59	52	41	63	43
3. Unfavorable	19	28	41	52	32	52
Nonmanufacturing (DI)	8	-1	-17	-26	-14	-33
1. Favorable	21	19	15	13	8	7
2. Not so favorable	66	61	53	48	70	53
3. Unfavorable	13	20	32	39	22	40

(Source: Bank of Japan)

### Investment plan looking ahead

Fixed investment in fiscal 2020 were down 0.8% from the previous year in all industries of all sizes in the survey of BOJ as shown in Chart (4). However, at 3.2% in all industries of large enterprises, fixed investment in both manufacturing and nonmanufacturing has not been impaired in large enterprises.

Generally speaking, the Japanese enterprises usually arrange the annual investment plan based on the fiscal year, which starts in April and ends in March next year. The business condition began to deteriorate at the beginning of the fiscal year 2020, but the enterprises have not lost their incentive to increase their investment, which we think is a positive indication.

As far as software investment is concerned, the total size of all industries is expected to grow by 4.8%. In other words, in the midst of the digitalization of the economy, we can see a positive attitude toward nurturing future sources of earnings, mainly through software investment.

The reason for such positive investment attitude is because, it has become obvious that there are many issues to be addressed when the enterprises are obligated to introduce the remote work that is significantly different from the previous work style before the COVID-19 outbreak. It is partially because there may be some movement to accelerate investment due to new awareness after the introduction of the new work style.

Since the capital investment amount by small enterprises are lower than those in the previous year, government's policy support for these areas is essential for future improvements in productivity.

**Chart(4) Investment FY2020 (Forecast)**

(year on year % change)

	All Enterprises	Large Enterprises	Small Enterprises
Fixed Investment including Land Purchasing Expenses			
Manufacturing	3.1	6.5	-10.4
Nonmanufacturing	-3.1	1.2	-20.1
All industries	-0.8	3.2	-16.5
Software Investment			
Manufacturing	5.0	4.4	-6.0
Nonmanufacturing	4.7	2.3	6.0
All industries	4.8	3.0	2.3

(Source: Bank of Japan)

## Human resource shortage

Although there has been a labor shortage in the past, there is a growing sense of an oversupply of work force as shown in Chart (5). Especially in the manufacturing enterprises, there was an oversupply of workers. However, the nonmanufacturing sector continues to be understaffed. This is because, while there are industries whose business sentiment has deteriorated, such as Accommodations, Eating & Drinking services, there exist industries in which business sentiment has proven good, such as Communications, with the latter still suffering from labor shortages.

From a medium- or long-term viewpoint, the enterprises tend to secure human resources in preparation for the next economic recovery phase, since there has been basic shortage of labor supply in the domestic labor market due to the low birthrate and aging population. In addition, there are policy supports by the government, such as the employment adjustment grants.

In the world "With COVID-19", smooth labor movement and matching are becoming increasingly important. In fact we can already see the change of recruiting activity using the Web and the remote work has been introduced in many enterprises. Thus, the enterprises are obliged to change themselves in order to capture the trend, in a time of great change.

**Chart (5) Employment condition and financial position**

	Large Enterprises		Small Enterprises	
	Jun.	Forecast	Jun.	Forecast
Employment Condition, DI("excessive" - "insufficient"),%points				
Manufacturing	9	3	13	8
Nonmanufacturing	-14	-16	-19	-22
All industries	-3	17	-7	-11
Financial Position, DI("easy" - "tight"),%points				
Manufacturing	9		-4	
Nonmanufacturing	11		1	
All industries	10		-1	

(Source: Bank of Japan)

Finally, I will check the financial positions (cash flow) of the enterprises. The financial position DI is calculated by subtracting the percentage of those who answered "tight" from the percentage of those who answered "easy". If the DI is positive, the financial position can be judged as relatively easy. Although the ratio of large enterprises dropped from +18 to +10, they still have sufficient funds. On the other hand, the ratio of small enterprises turned from +8 to minus1, indicating the funding environment has become "tight" for the first time since September 2013.

In the current crisis, the economic activities are partially stopped in order to avoid further spread of the COVID-19. While the sales disappeared, the cash flow of enterprises rapidly deteriorated due to continued payments such as for purchasing materials and rent. The government and financial institutions provided a wide range of financing support for enterprises from large to small sizes. Since the general concerns still remain for the time being, the government, while providing financing support for enterprises, will also need to provide its support for them to restore the normal management.

## World With/After COVID-19

In this way, although business confidence is deteriorating, its extent varies depending on the industry and size of the enterprise. Therefore it is necessary to keep ourselves vigilant, but not to be overly pessimistic. There still exist issues of human resource shortage and the enterprises have not lost their incentive to increase investment for growth. It is increasingly important to look at the world “With COVID-19” and “After COVID-19” and think about the future. For example, based on these BOJ survey results, which segment do you think will be relatively more important for enterprises as the target for their investment for future growth?

One answer would be “digitalization”. Although we have recognized the importance of digitalization, we realized the inadequacy of efforts given so far. Despite the criticism that the government’s digitalization has been delayed, it was due to the fact that the government has not allocated sufficient budgets for digitalization and has put more emphasis on the protection of privacy. This circumstance gave a chance for enterprises to revise their values and priorities. In fact some enterprises have introduced the remote work as a permanent system. As the Tankan this time shows the corporate intentions to increase the software investments, the Japanese enterprises are stepping further in the direction towards the digitalization.

The other answer is to review the production system and supply chain. This may be consistent with the “shift from great integration to great fragmentation” described only in the Editorial in *OECD Economic Outlook* (June 2020).

There used to be the cases where the movement of goods and people were restricted due to natural disasters. But this time, the fact that it was caused a worldwide pandemic made us realize its seriousness. The movement of people, goods, and money slowed down, and the pain caused by partial stoppage of economic activities heavily hit the fragile part of the economy and the society. This situation might lead to social division. While the globalization and integration have been the driving force for world economic growth so far, when we consider the experience this time, it would be also necessary to reevaluate the significance of fragmentation of the production system. Furthermore, it is important to pay more attention to the security issue, such as, how to secure enough masks, protective clothing and medicines as a countermeasure against the infectious disease. Thus it will be an important issue for Japanese enterprises to hit the balance between concentration and fragmentation.

In this way, in the midst of uneven business confidence, Japanese enterprises are struggling for the growth in the world “With and/or After COVID-19”.

## **Reference**

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