Daiwa's Economic View

BOJ Tankan September survey: Uncertainty eases

- Major improvement in corporate sentiment/earnings
- Strong capex appetite, uncertainty easing
- Inflation also more likely to reach 2% target

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Focus in September Tankan on tariff impact, forecast inflation

The Bank of Japan (BOJ) released the results of its September Tankan survey on 1 October. The BOJ positions today's Tankan and its upcoming branch manager meeting report as the last chance to confirm corporate trends ahead of its October Monetary Policy Meeting (MPM), as implied by the comment in the Summary of Opinions from its September MPM that "an examination of the Tankan...and anecdotal information from firms is required to determine whether firms have maintained their active business stance". The survey's response collection reference date was 10 September, after President Trump signed an executive order on lowering tariffs on auto imports from Japan.

We focus in today's Tankan release on (1) how the Japan-US tariff agreement affected corporate activity, and (2) how companies' growing desire to pass on higher costs mainly for food is affecting companies' inflation expectations.

Business sentiment: Manufacturers' sentiment improves on tariff policy developments

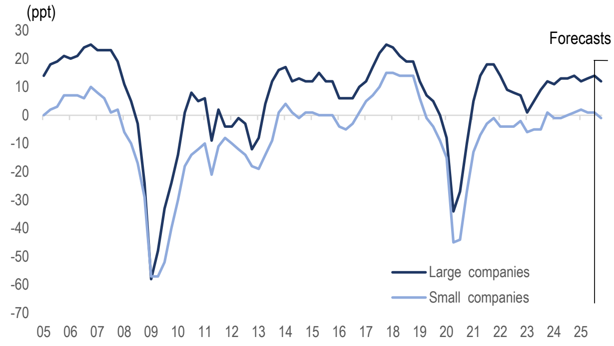
The business conditions DI in the September Tankan was up to +14 (from +13 in the previous survey) for large manufacturers and flat at +34 for large non-manufacturers, indicating an improvement at manufacturers in response to the US-Japan tariff agreement. The DI for small manufacturers was flat at +1, while for non-manufacturers it worsened to +14 (from +15).

Among large manufacturers, the DI for the auto sector improved to +10 (from +8 in the previous survey), remaining at a favorable level. The improvement came mainly from processing industries such as general-purpose machinery, production machinery, and electrical machinery, confirming a major advance in response to the US-Japan tariff agreement.

In contrast, the DI for large non-manufacturers was flat overall, with construction improving while accommodation, eating & drinking services worsened sharply to +26 (from +45 in the previous survey). We think sustained high raw material costs depressed sentiment in accommodation, eating & drinking services. However, the business conditions DI for large non-manufacturers remains high, suggesting that business conditions for non-manufacturers in general remain extremely favorable.

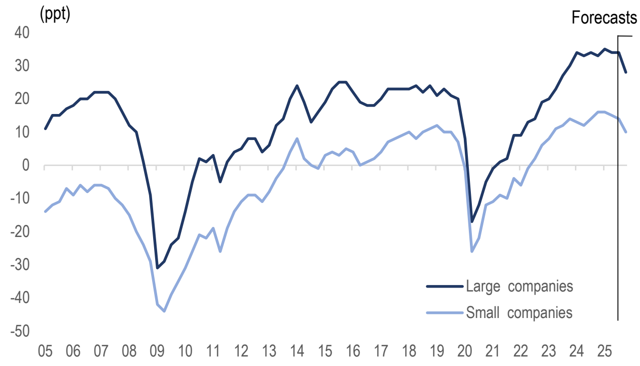
Large manufacturers' forecasts for the business conditions DI worsened slightly to +12 (down 2 from the previous survey), including +8 (down 2) for autos, but the negative impact was limited. Today's Tankan clearly indicates that tariff policy developments have had little impact on corporate sentiment.

Business Conditions DI (manufacturing)



Source: BOJ; compiled by Daiwa.

Business Conditions DI (non-manufacturing)



Source: BOJ; compiled by Daiwa.

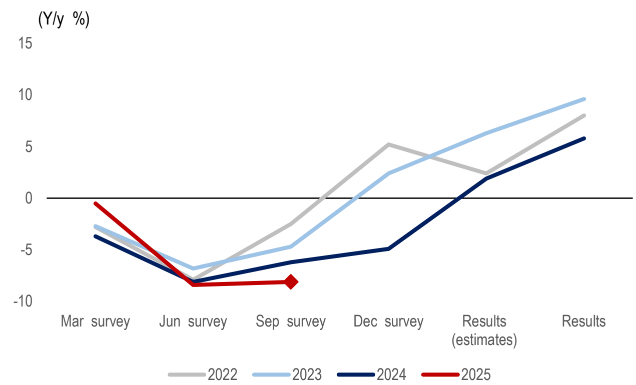
Recurring profit plans: Smaller decline than June survey; wage hikes may continue in 2026

FY25 recurring profit plans (all enterprises) were –8.1% y/y (–8.4% in the previous survey) for manufacturers and –2.3% (–3.7%) for non-manufacturers. Despite the US-Japan agreement, tariffs are still far higher than they were before Trump tariffs came in, and while companies now forecast a smaller y/y decline in profits, earnings face continued downward pressure.

However, the more important point is to what extent downward pressure on corporate earnings will affect next year's wage hikes. Our simulation using the Financial Statements Statistics of Corporations based on how much companies reduced FY25 recurring profit forecasts in the September survey suggests that while the labor share of income is set to rise in FY25, it should remain low.

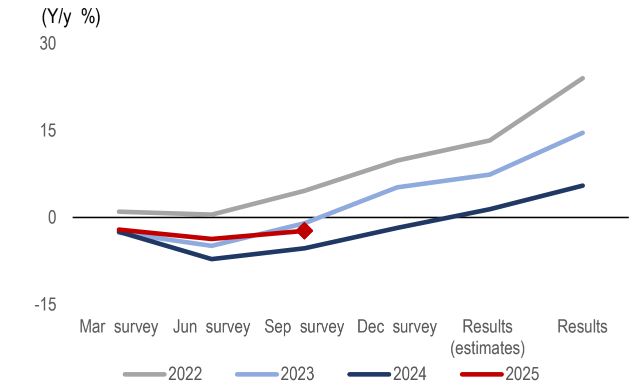
Even factoring in the downward pressure on corporate earnings from the series of developments surrounding Trump tariffs, we do not think the impact will be negative enough to materially worsen the outcome of the 2026 spring labor negotiations. We therefore now see the 2026 negotiations as more likely to result in a moderate level of sustained wage hikes supported by strong past corporate earnings.

Recurring Profit Plans (all-size manufacturers)



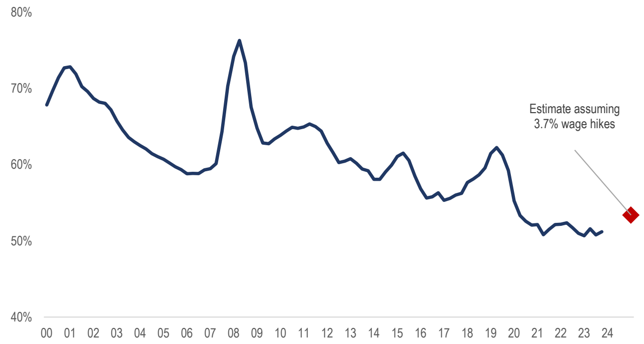
Source: BOJ; compiled by Daiwa.

Recurring Profit Plans (all-size non-manufacturers)



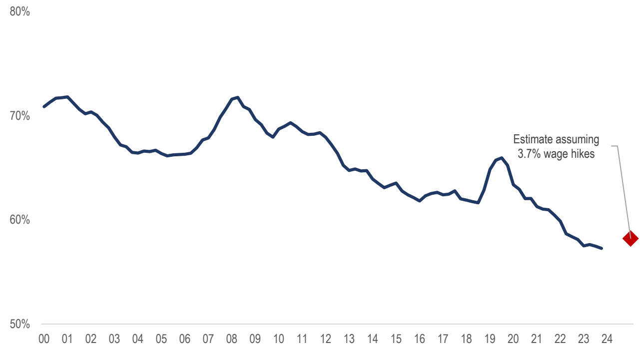
Source: BOJ; compiled by Daiwa.

Labor Share Estimate (all-size manufacturers)



Source: BOJ, MOF; 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 3.70%, in line with the increase in base pay agreed in the 2025 spring labor negotiations (as of final responses).

Labor Share Estimate (all-size non-manufacturers)



Source: BOJ, MOF; compiled by Daiwa.

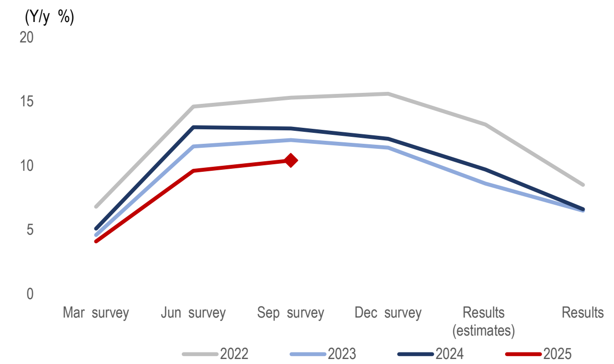
Capex plans: Uncertainty easing

We would particularly highlight the evidence of firms' strong capex appetite in today's Tankan. We had forecast a slight decline in FY25 capex plans on the assumption that uncertainty about tariffs would dampen companies' capex appetite.

However, capex plans in today's Tankan (excluding land purchases, including software and R&D) were revised up from +9.6% y/y to +10.4% for manufacturers and from +7.7% to +8.6% for non-manufacturers. Recent machinery order data and the Indices of Industrial Production (total capital goods supply) confirmed no major change in capex appetite, and today's Tankan also indicates that firms' capex appetite remains solid. Given the above, we think concerns about the impact of uncertainty on capex have eased considerably.

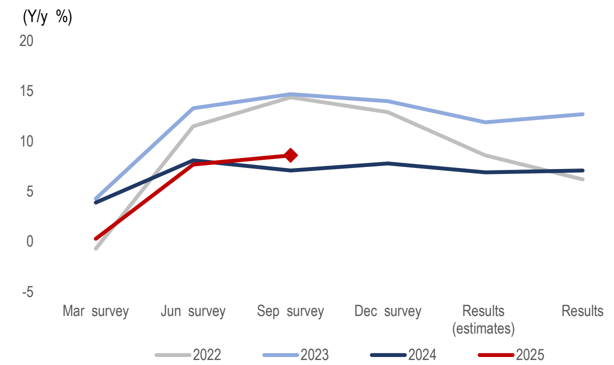
However, there are several caveats. We see the risk that FY25 capex could ultimately undershoot due to the quirk in the data whereby capex plans tend to decline from the December survey as firms postpone spending. That said, our simulation based on recent revisions suggests that large manufacturers' capex is still set to increase y/y, by around 3-6%. We think factors such as structural labor shortages and DX demand will support capex.

Fixed Investment Plans (all-size manufacturers)



Source: BOJ; compiled by Daiwa.

Fixed Investment Plans (all-size non-manufacturers)



Source: BOJ; compiled by Daiwa.

Inflation: More likely to reach 2% target

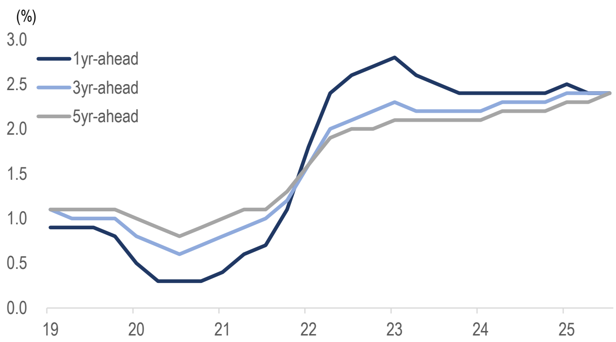
The Inflation Outlook of Enterprises (all enterprises, all industries), a key focus for the BOJ, remained high at +2.4% five years out (+2.3% in the previous survey).

The corporate goods price index (CGPI) continues to rise by around 2.5% as import prices settle and agricultural, forestry, and fishery products contribute to higher prices. Given changes in corporate price-setting behavior, mainly for food, we think corporate goods prices are shifting into a longer-term, domestically-driven pattern. We think this is supporting long-term inflation expectations.

We also note the recent decline in the input and output price DIs for large manufacturers. Meanwhile, the output price DI for large non-manufacturers has fallen more sharply than the input price DI. Taken together, this may indicate that companies' desire to pass on higher raw material prices has peaked. However, the output price DI remains elevated, consistent with the BOJ's outlook for consumer price inflation to gradually slow to 2%.

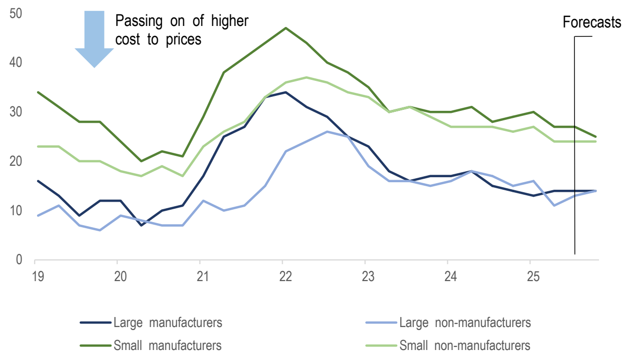
While there are signs that companies' desire to pass on rising costs has now peaked, it remains high, and rising long-term inflation expectations suggest that the BOJ's 2% price stability target is increasingly likely to be achieved. If the BOJ's Opinion Survey on the General Public's Views and Behavior (10 Oct), shows an upswing in households' inflation expectations, this would also heighten awareness of the need for an early rate hike to address rising prices.

Outlook for General Prices (all company sizes, all industries)



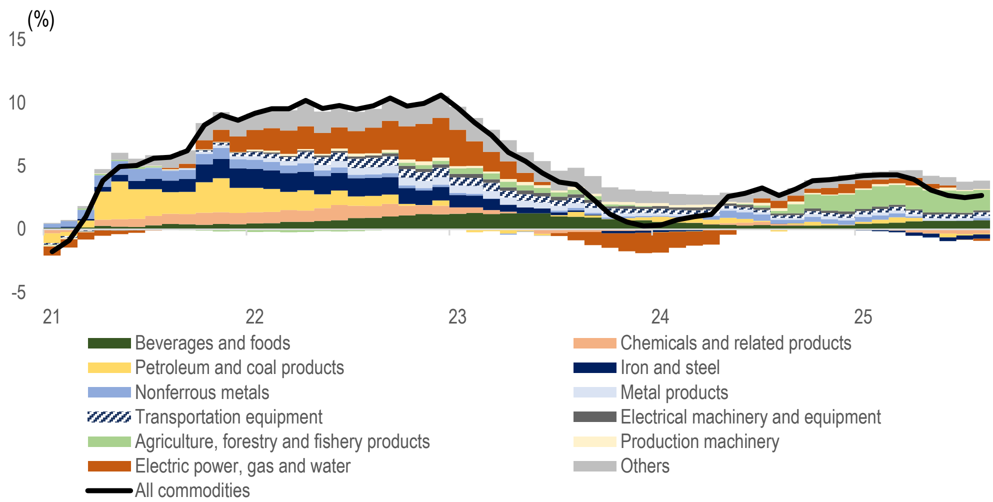
Source: BOJ; compiled by Daiwa.

Input Price DI – Output Price DI (Pseudo Terms of Trade)



Source: BOJ; compiled by Daiwa.

Breakdown of Contributions to Corporate Goods Price Index



Source: BOJ; compiled by Daiwa.

Summary: Balance of corporate trends and inflation suggests less need to wait for rate hikes

The BOJ Tankan (September survey) showed signs of major progress with corporate activity in response to tariff policy developments. Companies' inflation expectations are also rising, making the BOJ's 2% target more likely to be achieved. In short, the Tankan reduced the benefits for the BOJ of waiting while increasing the cost of waiting.

BOJ policy board member Asahi Noguchi's 29 September speech and the 30 September Summary of Opinions from the September MPM indicated a clear divergence in views on rate hikes amid an increase in the number of board members who favor them. BOJ Governor Kazuo Ueda emphasized at his September post-MPM press conference that the BOJ will continue to assess the impact of tariffs. Deputy Governor Shinichi Uchida will give a speech on 2 October, followed by a speech and press conference by Governor Ueda on 3 October; we will be watching whether the results of today's Tankan prompt a change in their views.

However, as per BOJ policy board member Asahi Noguchi's 29 September statement that "when focusing only on the domestic economic situation, I believe Japan will...require a new policy perspective," other indicators of corporate business sentiment had also improved prior to today's Tankan release. The focus for the BOJ is the likelihood of a US soft landing, and we expect it to leave its options open in this week's speeches by the governor and deputy governor ahead of the release of September US employment data and the US CPI.

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