

Daiwa's Economic View

December Tankan: Supports December BOJ rate hike

- Business sentiment, earnings, perceived labor shortages imply substantial wage hikes
- Concerns about sustained high long-term inflation
- Tankan's implications for BOJ messaging on terminal rate

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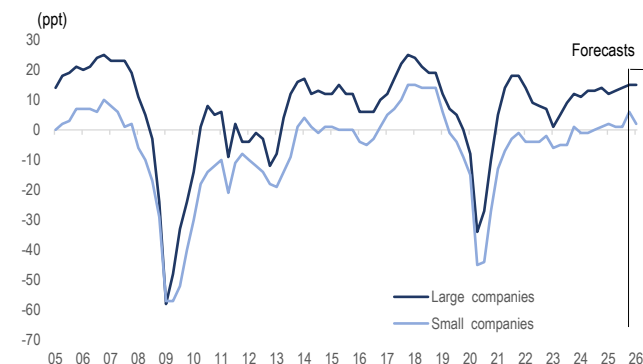
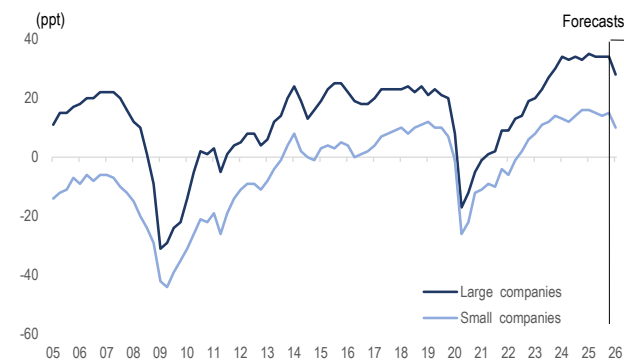
The Bank of Japan's (BOJ) Tankan (released 15 Dec) was its last opportunity to confirm corporate trends before the December Monetary Policy Meeting (MPM). We think corporate business sentiment, recurring profit, and perceived labor shortages are particularly important in gauging the initial momentum of the upcoming spring labor negotiations. Given the survey's 26 November response date, there were concerns about the impact of the Chinese government's request for its citizens to refrain from traveling to Japan.

Business sentiment: Still good; limited impact from worsening China-Japan relations

The business conditions DI in the December Tankan was up to +15 (from +14 in Sep) for large manufacturers and unchanged at +34 (+34) for large non-manufacturers, with improvements centering on manufacturers. The DI for small manufacturers also rose to +6 (from +1), while for non-manufacturers it rose to +15 (from +14), with improvements for both.

Among large manufacturers, the DI for the auto sector worsened to +9 (from +10 in the previous survey), but remained at a favorable level. The DIs for large non-manufacturers also remained high at +30 (+30) for services for individuals and +25 (+26) for accommodation, eating & drinking services, implying a minimal impact from worsening China-Japan relations at this point. Overall, corporate business sentiment looks unlikely to impede progress toward the 2026 spring labor negotiations.

Large manufacturers' forecasts for the business conditions DI remained at +15 (unchanged from the previous survey), while non-manufacturers' forecasts fell to +28 (down 6). While we think this reflects concerns about worsening China-Japan relations, we see no need for undue concern based on the high forecasts for the business conditions DI.

Business Conditions DI (manufacturing)**Business Conditions DI (non-manufacturing)**

Recurring profit plans: Smaller decline than Sep survey; substantial wage hikes to continue in 2026

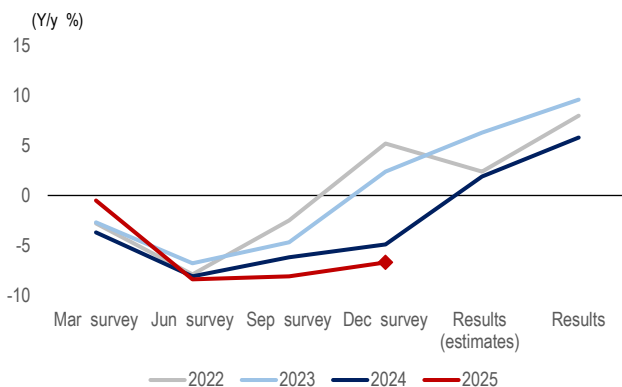
FY25 recurring profit plans (all-size enterprises) improved to -6.7% y/y (-8.1% in the previous survey) for manufacturers and +0.4% (-2.3%) for non-manufacturers. While US tariff policy is undoubtedly squeezing FY25 corporate earnings, we think the impact is likely to be relatively minor.

We would also note that business plans particularly at exporters assume a forex rate of ¥146.53/\$ in FY25 (¥146.33/\$ in 2H), implying a much stronger yen than current levels. If the yen remains weak, we think FY25 recurring profit forecasts and results are likely to exceed current guidance.

Our simulation using the Financial Statements Statistics of Corporations by Industry based on how much companies reduced FY25 recurring profit forecasts in the December survey suggests that while the labor share of income is set to rise in FY25, it remains low.

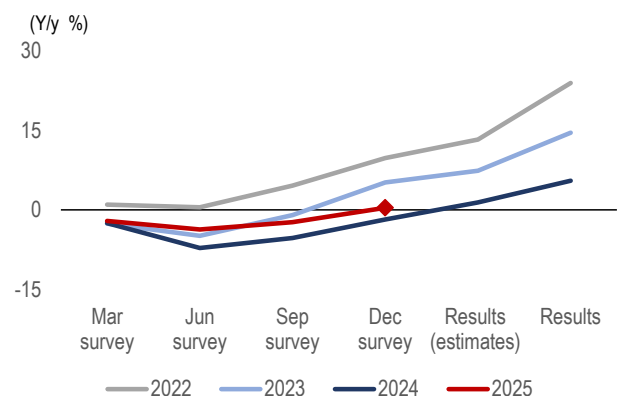
The employment conditions DI for all-size enterprises in all industries was -38 (-36 in Sep), indicating a further increase in perceived labor shortages. New hiring plans (all-size enterprises, all industries) for FY26 also remain high, at +7.2% y/y (FY25 new hiring plans in Dec 2024 survey: +8.8%). Corporate business sentiment, recurring profit, and perceived labor shortages all suggest that the FY26 spring labor negotiations are increasingly likely to result in substantial wage hikes.

Recurring Profit Plans (all-size manufacturers)



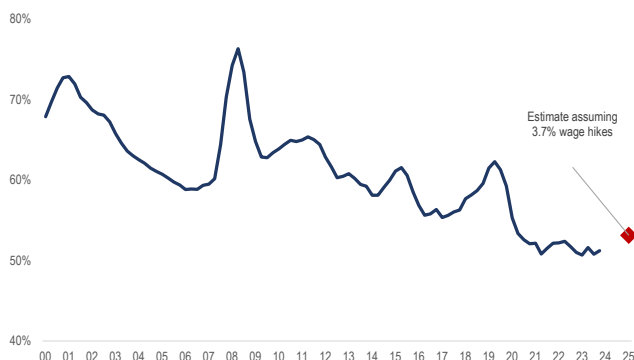
Source: BOJ; compiled by Daiwa.

Recurring Profit Plans (all-size non-manufacturers)



Source: BOJ; compiled by Daiwa.

Labor Share Estimate (all-size manufacturers)



Source: BOJ, MOF; compiled by Daiwa.

Labor Share Estimate (all-size non-manufacturers)



Source: BOJ, MOF; compiled by Daiwa.

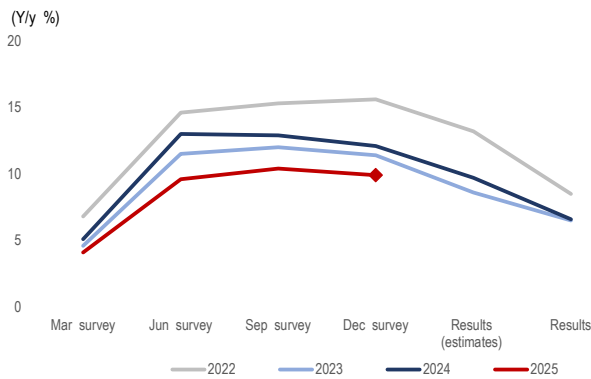
Capex plans: Actual capex more likely to remain high

FY25 capex plans (excluding land purchases, including software and R&D) were revised down from +10.4% y/y to +9.9% for manufacturers of all sizes and revised up from +8.6% to +9.1% for

non-manufacturers. Companies' capex appetite remains firm despite growing visibility on the impact of US tariff policy.

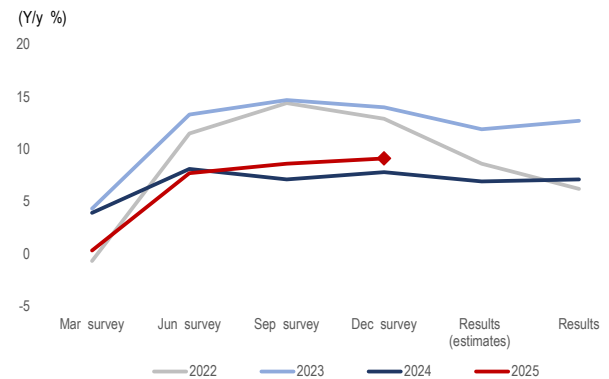
We would note that companies have tended to scale back capex plans from the December survey partly because they postpone spending. Adjusting for this factor, we think recent percentage revisions suggest that growth in capex at all sizes of manufacturer should remain generally positive at around +5%, implying that actual capex will remain high.

Fixed Investment Plans (all-size manufacturers)



Source: BOJ; compiled by Daiwa.

Fixed Investment Plans (all-size non-manufacturers)



Source: BOJ; compiled by Daiwa.

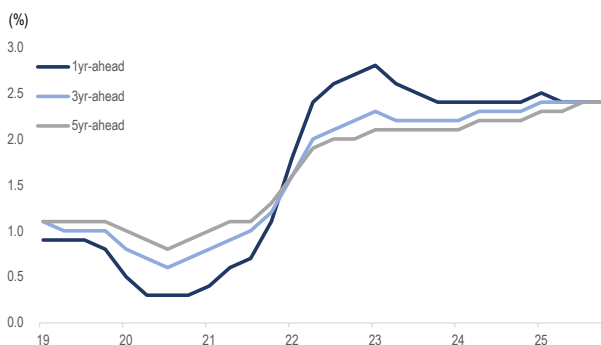
Concerns about sustained high long-term inflation

The inflation outlook of enterprises (all-size enterprises, all industries), a key focus for the BOJ, remained high at +2.4% five years out (unchanged from the Sep survey). However, large non-manufacturers revised up their forecasts to +2.0% (from +1.9%). Trends for other sizes of firm and sectors remained broadly flat.

Corporate goods prices continue to rise strongly (+2.7%y/y) as falling import price inflation is offset by a sustained rise in prices for agricultural, forestry, and fisheries products and food and beverages. The December Tankan showed input and output price DIs rising for both large manufacturers and non-manufacturers. The future conditions DI for input prices in particular continues to trend upward, reaching +43 for manufacturers (up 3 from the Sept survey) and +46 for non-manufacturers (up 2).

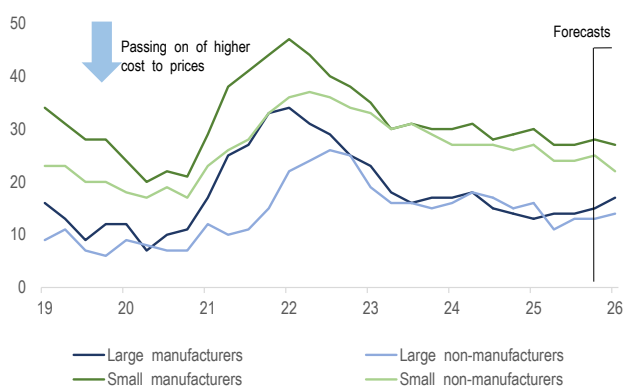
An increasing number of firms expect input prices to rise due to the yen's recent weakness and progress with passing through higher costs, which is also driving up the outlook for output prices. There is no evidence from these trends that companies' desire to pass through higher costs is waning, implying that inflation could remain high in the long run.

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.

Tankan's implications for BOJ messaging on terminal rate

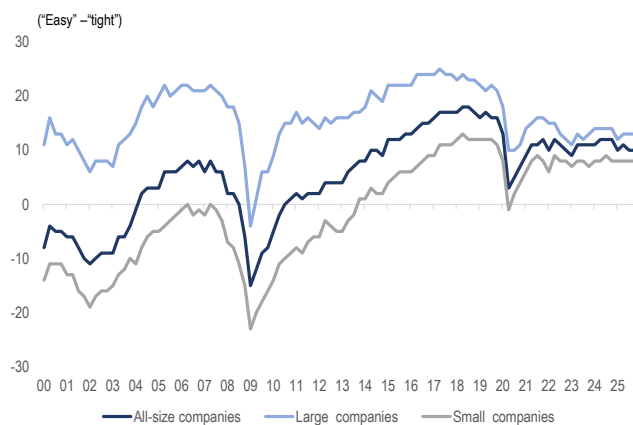
The results of today's Tankan make it more likely that the 2026 spring labor negotiations will result in substantial wage hikes, supporting a December rate hike by the BOJ. We expect a rate hike at the December MPM barring sudden major market moves in response to upcoming US employment and other data.

Another focus of attention at the December MPM will be the BOJ's assessment of the degree of easing implied by its current policy rate; we think it will focus in particular on lending trends as a gauge of whether the current rate is accommodative. Both the financial position DI and lending attitude of financial institutions DI in the latest Tankan survey remained accommodative.

We think the BOJ will take the view at the December MPM that uncertainty created by US tariff policy is easing and that today's Tankan confirmed the initial momentum of the FY26 spring labor negotiations. We also expect it to indicate that financial conditions remain accommodative based on growth in total average loan balance (+4.2% y/y as of Nov) in the Principal Figures of Financial Institutions and the financial position/lending attitudes DIs in the December Tankan.

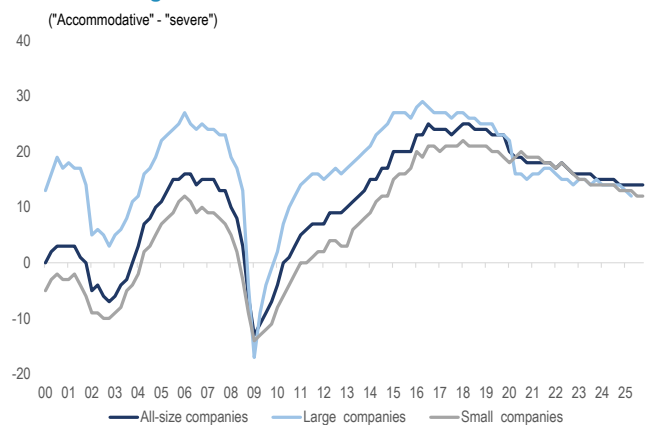
However, the lending attitudes DI also implies that the degree of easing is gradually narrowing. Based on the above, we expect the BOJ to communicate that interest rates are "at least nearing the neutral rate, but still accommodative".

Financial Position DIs



Source: BOJ; compiled by Daiwa.

DIs on Lending Attitude of Financial institutions



Source: BOJ; compiled by Daiwa.

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