# 1986 Industrial Forecast

Compiled by the Industrial Research Department of the Industrial Bank of Japan, Ltd.

## Japanese Industry Facing Harsh Prospects

The Japanese economy has been on an expansionary path ever since hitting rock bottom in the spring of 1983. This growth phase has lasted for close to three years, but the tempo of expansion seems to be slowing down.

Bolstered by the robust recovery of the American economy, Japan's exports of goods to the United States have soared, led by the output of the nation's assembly and processing industries. This steep increase has had a favorable effect on Japan's domestic demand in the form of an appreciable increase in business investments in plant and equipment. As a result, many Japanese concerns enjoyed rising profits through the financial year ended last March.

However, early in the second half of 1985 general economic activity began to deteriorate, and the business outlook became clouded. The U.S. economy, which until then had played the role of locomotive worldwide, slowed. U.S.-Japan frictions over Japan's trade surplus promised to worsen. To cap things off, as a result of the yen's sharp appreciation against the U.S. dollar since the Group of Five meeting last September, the profit position of Japanese export industries now threatens to deteriorate in the months ahead.

Given these background factors, it is not surprising that pessimism is gaining ground, especially among the export industries. Nor do the prospects for a mild recession in the American economy in 1986, based on our projections, do anything to dispel the gloom.

U.S. consumer spending, which has already gone a little too far, is likely to decline rapidly in the first half of 1986. Housing investments and business spending on plant and equipment and inventory will grow sluggish.

Nor are these expected developments in Japan's largest export market the only bad news on the horizon. Japanese exports to China, which bounded forward up until 1985, will likely decrease over this year because of China's worsening foreign exchange position. Taken all together, the setbacks will drive down Japanese exports of trucks and automobiles slightly. Exports of electric and electronic machinery are projected to remain virtually unchanged in 1986, although even this is an improvement over the small decrease in 1985.

On the domestic demand side, capital investment and personal consumption remain comparatively firm for the moment. Plant and equipment spending by the manufacturing industry as a whole may sag somewhat in 1986, but the setback will likely be offset by increased investments in the nonmanufacturing sector. Personal consumption should be generally steady, although a slowdown could appear in the latter half of the year.

In sum, Japanese manufacturing companies are likely to register lower profits in 1986. This is particularly true of export-oriented businesses, while nonmanufacturing concerns will be in comparatively firmer shape. With business activity at less than its best, 1986 will be a year in which the government finds itself under strong pressure for a substantive program to promote domestic demand.

(Kazuhisa Takata, senior economist)


## Steel

Japan's crude steel production, supported by strong demand both at home and overseas, maintained an uptrend from the second quarter (July–Sept.) of fiscal 1983 through the first quarter (Apr.–June) of fiscal 1985. During this period, output exceeded the year-before levels for eight consecutive quarters. However, production has been falling short of the year-before levels since the second quarter (July–Sept.). The downtrend has been caused by sluggish domestic demand, Japan's voluntary restraints on exports to the United States, and the delay in shipments to China, Japan's largest export market, brought on by serious port congestion in China.

The Japanese steel industry is likely to face a bleak outlook in fiscal 1986 starting in April, with demand expected to turn slow both at home and overseas. The prospects are gloomier than in fiscal 1985.

In the domestic market, demand from the construction industry, one of the major users of steel products, in fiscal 1986 can hardly be expected to exceed the previous year's level (refer to "Construction" on p.48). Among the manufacturing industries, demand from the automobile industry, which helped to boost steel output in fiscal 1985, is expected to slow in fiscal 1986. Demand from the shipbuilding industry will also remain sluggish due to reduced work at shipyards. Domestic demand as a whole will inevitably decline from the fiscal 1985 level.

On the export markets, demand from China is expected to remain brisk as the country's seventh five-year development plan starts in 1986. But shipments to the United States will continue to be held down under the voluntary export restraint arrangement. Exports to other areas may not increase either in view of a prospective slowdown in economic growth.

If the yen's high rate against the U.S. dollar settles down, Japan's steel imports may somewhat increase chiefly from South Korea, Taiwan, and Brazil.

Japan's crude steel output in fiscal 1986 will inevitably decline from the previous year. Due partly to lower mill operation rates resulting from reduced production and partly to lower export prices caused by slow demand overseas, steel mills in fiscal 1986 will probably fare even worse than in fiscal 1985 when their earnings are seen to fall short of the year-before levels. Overall, 1986 will be a year of ordeal for the Japanese steel industry.

(Hideo Yagi, senior economist)

**Crude Steel Output** (million metric tons)

| FY 1984 | FY 1985 (estimate) | FY 1986 (forecast) |
|---|---|---|
| 106.5 | 103.0 | 99.0 |

Cloudy, partly rainy

# Petrochemicals

The Japanese petrochemical industry, which enjoyed the best business yet in 1984 thanks to global economic recovery, will gradually enter a difficult phase in 1986. Some unfavorable factors are surfacing, including economic slowdown, the yen's appreciation against the U.S. dollar, and the full-fledged start-up of new petrochemical projects in Saudi Arabia and other countries.

Large-scale petrochemical projects started operation in Saudi Arabia and Canada early in 1985. However, both projects ran into trouble later. A petrochemical plant accident also occurred in Europe. With global demand for petrochemicals remaining firm, the new massive projects have little affected the Japanese industry. Domestic demand has also been in good shape, keeping production high throughout 1985.

Domestic market prices have been easy under the pressure of stocks built up throughout 1984, and particularly under the influence of sagging international prices since last summer. However, thanks to continued high-level production and the reduced prices of naphtha, Japanese petrochemical companies will enjoy good business throughout fiscal 1985 (ending on March 31), though their profits will decline somewhat from the previous year.

Fiscal 1986 will find few favorable factors for the industry. Given such unfavorable factors as recession in the U.S., China's reduced imports, and an economic slowdown in Japan, demand will either level off or decline somewhat in the new year.

The Saudi and Canadian petrochemical projects will start giving a full impact on the Japanese petrochemical industry, the international market will ease off, and the yen will remain strong against the U.S. dollar. The result will be an appreciable deterioration in Japan's balance of trade in petrochemicals.

If, as a result of the U.S. recession, surplus petrochemicals flow into Japan, the Japanese industry might face a severer situation. Drops in domestic petrochemical prices may prove greater than those in naphtha prices. Japanese companies may feel forced to increase their production to cover profit declines, adding to the already abundant stocks of petrochemicals. Such excess stocks will naturally have adverse effects on the supply and demand of petrochemicals.

Japanese companies should seek to improve their industrial structure through orderly production instead of resorting to production expansion.

(Junro Mitsuoka, senior economist)

**Petrochemicals Supply and Demand** (in terms of ethylene: 1,000 metric tons)

| | FY 1981 | FY 1982 | FY 1983 | FY 1984 | FY 1985 (estimate) | FY 1986 (forecast) |
|---|---|---|---|---|---|---|
| Domestic demand | 3,640 | 3,610 | 3,810 | 4,080 | 4,320 | 4,370 |
| Exports | 450 | 430 | 430 | 430 | 270 | 220 |
| Imports | 340 | 410 | 400 | 440 | 500 | 580 |
| Output | 3,590 | 3,570 | 3,970 | 4,340 | 4,080 | 4,100 |
| Ordinary profit (¥ billion) | −24.1 | −42.7 | 34.8 | 136.9 | 90.5 | 40.0 |

Note: Profit represents the combined profit of five integrated chemical companies and two specialized petrochemical companies.

Fine, occasionally cloudy

# Automobiles

The Japanese automobile industry will see its best year in the period ending March 31, 1986, with production, sales, and earnings all reaching record highs.

By contrast, the industry faces bleak prospects for fiscal 1986, with production likely to level off and profits to decrease.

Automobile production, estimated to increase 7% in fiscal 1985, is seen to remain almost unchanged in fiscal 1986, due to a prospective slowdown in exports and sluggish demand at home.

The sharp export increase in fiscal 1985 has been brought on by a steep growth in car shipments to the United States. In fiscal 1986, however, no sharp increase in exports to the U.S. is likely. Rather, they may even decline.

Motor vehicle exports to China, which began leaping in the latter half of fiscal 1984, have started to decline rapidly since the latter half of fiscal 1985 under China's economic adjustment policy made necessary by a deterioration in the country's foreign exchange position. Exports to China are not likely to recover in fiscal 1986.

No appreciable increase is expected either in exports to other areas; overall auto exports in fiscal 1986 will probably suffer the first setback in four years.

Not much can be expected of domestic demand in fiscal 1986 either. Domestic demand has been recovering since the latter half of fiscal 1985, but the pace of recovery has been very slow. It is projected to show a meager 1 percent gain in fiscal 1986. Demand for cars will likely increase moderately, while that for commercial vehicles (not including light vans which are used like cars) will probably continue to sag as it did in fiscal 1985.

The industry will show a bleak earnings performance in fiscal 1986. Japanese automakers earn much of their profits from car exports to the U.S. This has typically been the case in fiscal 1985. In fiscal 1986, however, they can hardly hope for a repetition of the same performance.

To make matters worse, exports to China are likely to plunge in this year. Slow production will mean that fixed costs will increase. And the yen's appreciation against the U.S. dollar will cut profits.

All these will combine to push down dramatically the industry's profits in fiscal 1986.

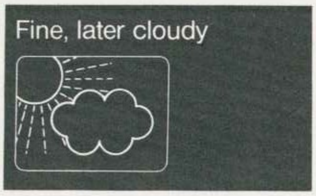
(Shigeki Yana, senior economist)

**Automobile Output and Demand**

(In 1,000s)

| | FY 1984 | FY 1985 (estimate) | FY 1986 (forecast) |
|---|---|---|---|
| Domestic demand | 5,484 (0.5) | 5,550 ( 1.2) | 5,640 ( 1.6) |
| Exports | 7,065 (8.4) | 7,920 (12.1) | 7,860 (−0.8) |
| Output | 12,527 (4.1) | 13,420 ( 7.1) | 13,440 ( 0.1) |

Note: Figures in parentheses denote the rate of increase over the previous year.




# Machine Tools

Japan's machine tool industry, which started recovering in late 1983, has since been growing smoothly, producing an estimated ¥1 trillion ($4.88 billion) worth of products in 1985. Much of the growth was due to increased demand for general-purpose numerically controlled (NC) machine tools, stemming from further progress in factory automation in Japan and other countries. Japan's NC machine tool ratio has gone up steadily to stand close to 70% now.

**Machine Tool Production** (¥ billion)

| CY 1984 | CY 1985 (estimate) | CY 1986 (forecast) |
|---|---|---|
| 881.5 (25.5) | 1,050.0 (19.1) | 1,090.0 (3.8) |

Note: Figures in parentheses denote the rate of increase over the previous year.

Exports of general-purpose NC machine tools to the United States have increased sharply, making the greatest contribution to the growth of the Japanese machine tool industry. This may prove that Japan is now overwhelmingly competitive in the field of general-purpose NC machine tools.

The market for factory automation equipment will continue to expand in the years ahead, assuring good business prospects for Japanese machine tool builders. In 1986, however, a worldwide recession is expected, and the Japanese machine tool industry may enter a leveling-off phase.

In Japan, under the influence of the computer slump since early 1985, machine tool demand from the electronics industry has slowed though demand from the automotive industry has been brisk. In 1986, no quick recovery is anticipated in the electronics industry. Nor can much be expected of equipment investment by the automobile industry.

Exports have been fast growing, mainly to the U.S. But imports, mostly from Japan, account for close to 50% of total U.S. demand for machine tools. This could lead to fresh trade friction between the two countries. The yen's appreciation against the U.S. dollar, a possible U.S. economic recession and the entry into the U.S. market of more European products would make Japanese machine tool exports considerably harder in 1986. This year, neither domestic demand nor exports will plummet but the pace of growth in both sectors will slow markedly.

Many Japanese machine tool companies have expanded their production capacity. Once demand slows, an oversupply will start sending the market lower. Depending on the extent of equipment modernization, the gap in cost-competitiveness among individual machine tool builders has been widening. For less competitive machine tool builders, 1986 will really be a year of ordeals.

(Kimitaka Ishizaka, senior economist)


# Semiconductors

Japan's semiconductor exports in 1985 suffered a heavy setback, hard hit by the computer slump in the United States. Normally about 40% of Japan's integrated circuit (IC) output is exported, and roughly half the total exports are shipped to the United States.

About half the U.S. semiconductor market is accounted for by suppliers of office automation equipment and computer manufacturers. The current slump in sales of computers, ranging from personal computers (PCs) to mainframes, has caused a significant effect on Japanese semiconductor manufacturers, whose exports are likely to remain sluggish throughout the first half of 1986.

**IC Output and Exports** (¥ billion)

| FY 1985 | 1st half | 2nd half | Total |
|---|---|---|---|
| Output | 978.2( −1.1) | 1,025.2( −8.4) | 2,003.4( −5.0) |
| Exports | 289.7(−27.7) | 266.0(−36.3) | 555.7(−32.1) |
| **FY 1986** | **1st half** | **2nd half** | **Total** |
| Output | 995.0 (1.7) | 1,138.0 (11.0) | 2,133.0 ( 6.5) |
| Exports | 290.0 (0.1) | 328.0 (23.3) | 618.0 (11.2) |

Notes: Figures in parentheses denote the rate of change over the previous periods.
Figures for the 2nd half of FY 1985 are estimates and those for FY 1986 forecasts.

The marketing by IBM of a new mainframe, dubbed "Sierra," in February 1985, and the announcement of a PC local area network (Token Ring) in October 1985 have begun to help the U.S. computer industry to recover gradually from the slump. However, no full-scale recovery of semiconductor demand will begin until new PCs with improved communication functions go on sale. The question now is how soon IBM, Apple Computer Inc., and other makers can develop and market new PCs suited to user needs.

There are now semiconductor trade frictions going on between Japan and the U.S. following the complaint filed by the U.S. Semiconductor Industry Association (SIA) under Section 301 of the U.S. Trade Act, and the EPROM dumping charge filed by Intel Corp. and other makers. In both cases, the charge is against Japanese semiconductor makers. How these complaints are dealt with will affect the shape of semiconductor business in the years ahead.

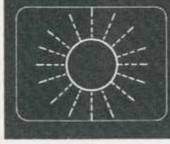
Domestic demand for semiconductors is likely to decline in the first half of 1986. Semiconductor shipments to manufacturers of PCs for business uses and office computers will hold relatively firm. But in the consumer electronics division, shipments to VCR manufacturers, which account for more than 10% of semiconductor demand, are likely to be slow. Shipments to color TV manufacturers will also decrease due to reduced color TV exports to China.

There will be some increase in demand from manufacturers of such new products as compact disk and videodisk players, but it will be too small to make up for the reduced demand from VCR makers.

Judging from these projections, Japan's output of semiconductors, including discrete devices, will show a slight 1.6 percent growth over the previous period in the first half of 1986, though it will recover to register a 10.1 percent increase in the latter half.

(Makoto Tamaki, senior economist)

Fine



# Computers and Communications Equipment

This year's output of information-related equipment in Japan will probably maintain a double-digit increase from the previous year under the lead of office computers and 16-bit personal computers for business uses. The high growth will be supported by further progress in office automation and stepped-up computerization by the distribution and services industries.

Japanese exports of computer mainframes and peripherals to the United States and other countries have been slow in recent months, reflecting sluggish demand for a wide assortment of information-related equipment ranging from personal computers to general-purpose computers. The impact of this slow demand will continue into 1986. The "computer slump" has been caused by a saturated market for home computers and users' purchase restraints in anticipation of the marketing of new products.

However, it is expected that personal computers of new types, with an enhanced communication function, will be marketed in the latter half of 1986, helping to improve the export market for various suppliers, such as OEM (original equipment manufacture) suppliers of peripherals and personal computers.

The production of information-related equipment in 1986 will register a 9.9 percent growth over the year before.

In contrast, both domestic and overseas demand for communications equipment will maintain a double-digit increase in 1986. Japan's production of communications equipment will grow 13.2% over the year before.

There will emerge new demand for information equipment as a result of the formation of information networks among distribution enterprises. The establishment of facsimile networks by Nippon Telegraph and Telephone Corp. (NTT) will create new demand for small, high-speed facsimiles. There will also emerge new demand for various types of new media equipment among enterprises seeking to use NTT's teleconference service.

Japanese exports of communications equipment to the U.S. and other countries will fare well in 1986. There will be greater demand for various types of data communications equipment and relay equipment for use in communications networks.

However, there is an uncertain factor—the ongoing trade friction between Japan and the U.S. over communications equipment. How this issue develops may deteriorate the export prospects, necessitating a downward revision of the projection given above.

(Makoto Tamaki, senior economist)

**Output and Exports of Industrial Electronic Machinery** (¥ billion)

| FY 1985 | 1st half | 2nd half | Total |
|---|---|---|---|
| Output | 3,493.0 (16.1) | 3,667.3 (12.5) | 7,160.3 (14.2) |
| Exports | 1,358.5 (12.3) | 1,477.8 ( 7.4) | 2,836.3 ( 9.7) |
| **FY 1986** | **1st half** | **2nd half** | **Total** |
| Output | 3,856.4 (10.4) | 4,140.9 (12.9) | 7,997.3 (11.7) |
| Exports | 1,456.7 ( 7.2) | 1,649.5 (11.6) | 3,106.2 ( 9.5) |

Notes: Figures in parentheses denote the rate of increase over the previous year.
Figures for the 2nd half of FY 1985 are estimates and those for FY 1986 forecasts.

Fine, occasionally cloudy

# Electric Appliances

Japan's output of home electric and electronic appliances in 1986 is projected to decrease by about 1.6% from 1985, due chiefly to two factors: slackening demand for video cassette recorders (VCRs) and a sharp setback in color TV exports to China.

VCRs now account for 30% of the home electric and electronic appliances output, but demand for VCRs, both at home and overseas, is slowing down. Japanese color TV exports to China are likely to plunge in 1986 due to the deterioration in China's foreign exchange position.

Profit performances of Japanese manufacturers of home electric and electronic appliances in fiscal 1986 will probably remain about the same as the year before.

VCR production is not likely to grow in 1986 because the diffusion rate has already topped an estimated 30% both in Japan and the United States, which takes 60% of Japan's annual VCR exports. The introduction of new products like 8mm video camera-recorders has made consumers hesitant to buy conventional VCRs. Moreover, VCR prices are likely to go down further as a result of the marketing of low-priced VCRs by South Korean manufacturers. In Europe, Japanese VCR exporters are faced with two delicate problems—a rise in the import duty and a possible continuation of voluntary export restraints.

The domestic market for color TVs, refrigerators, and washing machines has already matured, and Japanese manufacturers have expanded their production, prompted by fast-growing exports to China. The Chinese market has grown to account for 50% of Japan's total exports of such appliances. But China's foreign exchange shortage would mean that the exports of such appliances may decrease 20–30% in 1986.

Domestic shipments of air-conditioners increased appreciably in 1985 thanks to a hot summer. In 1986, shipments are likely to decrease somewhat. However, sales of high-grade models will probably pick up. So the drop in the total air-conditioner sales in 1986 is likely to remain slight.

Encouraging are the increasing production and sales of compact disk players. Their production and sales began increasing in Japan in early 1985 after low-end models priced below ¥50,000 ($244) were put on the market. The output of compact disk players in 1986 is estimated to top 4 million, valued at ¥200 billion ($976 million). They will account for just below 3% of Japan's total production of home electric and electronic appliances.

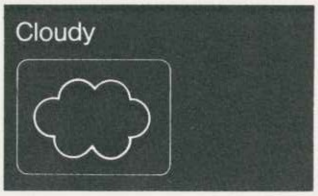
(Makoto Tamaki, senior economist)

**Output and Exports of Home Electric and Electronic Appliances**

(¥ billion)

| FY 1985 | 1st half | 2nd half | Total |
|---|---|---|---|
| Output | 3,467.4 (4.9) | 3,468.6 (−1.5) | 6,936.0 (1.6) |
| Exports | 2,079.7 (5.5) | 1,987.7 (−2.3) | 4,067.4 (1.6) |
| **FY 1986** | **1st half** | **2nd half** | **Total** |
| Output | 3,316.4 (−4.4) | 3,506.8 (1.1) | 6,823.2 (−1.6) |
| Exports | 1,956.2 (−5.9) | 1,996.4 (0.4) | 3,952.6 (−2.8) |

Notes: Figures in parentheses denote the rate of increase over the previous year.
Figures for the 2nd half of FY 1985 are estimates, and those for FY 1986 forecasts.




# Textiles

The Japanese textile industry gave a relatively poor performance in 1985. While clothing manufacturers benefited from steady consumption helped by business recovery, the synthetic fiber producers and cotton spinners fared badly due to supply problems.

In the synthetic fiber division, the market for polyester filament yarn and fabrics remained in the doldrums, hard hit by high wholesaler stocks of fabrics. The excessive stocks were the result of overproduction by weavers since 1983. Since the spring of 1985, efforts have been made to reduce the glut. However, little progress has been made so far and the market remains bearish.

The cotton yarn market has also fallen markedly to ¥260–¥270 ($1.30) per pound, about ¥100 below the levels a year earlier, due to a sharp increase in imports and the yen's steep appreciation against the U.S. dollar since last autumn. Against the backdrop of a worldwide bumper raw cotton crop in the year from August 1984 to July 1985, cotton yarn imports soared 61% in 1984 from the previous year and 19% in the first half of 1985. This made the Japanese cotton yarn market much easier. Though Japanese spinners enforced production cutbacks, the market plunged, hit by another unfavorable factor–the yen's appreciation.

In 1986, it looks like the supply problems facing the synthetic fiber sector will be solved one by one. Both domestic and overseas demand for polyester filament fabrics is likely to recover again as consumers gradually return to man-made fiber from natural fiber. Production restraints will also begin to work, gradually reducing excessive wholesaler stocks of polyester fabrics.

Synthetic fiber makers are likely to chalk up increased profits in fiscal 1986, supported by some improvement in their fiber division and continuing good business in their nonfiber division. This will be in contrast with a slight profit decline expected in fiscal 1985.

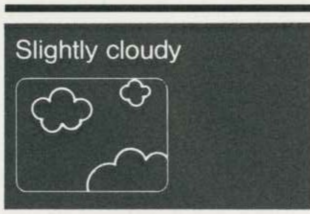
On the other hand, cotton spinners are likely to mark time in fiscal 1986 after suffering reduced profits in fiscal 1985. The reason is ongoing pressures from cotton yarn imports as another good crop is expected in the current raw cotton year from August 1985 to July 1986. Despite the Japanese industry's continued production restraints, the cotton yarn market is not likely to recover appreciably in fiscal 1986.

(Mitsuaki Tsuchiya, senior economist)

**Synthetic Fiber and Spun Cotton Yarn Output** (1,000 metric tons)

| | FY 1984 | FY 1985 (estimate) | FY 1986 (forecast) |
|---|---|---|---|
| **Synthetic fiber** (yarn and staple) | 1,418 (2.3) | 1,453 (2.5) | 1,482 (2.0) |
| **Spun cotton yarn** | 1,235 (4.6) | 1,241 (0.5) | 1,249 (0.6) |

Note: Figures in parentheses denote the rate of increase over the previous year.




# Pharmaceuticals

The Japanese pharmaceutical industry, which enjoyed high profits in the past, has been under harsh conditions in recent years, due chiefly to efforts being made by the deficit-ridden government to hold down payments under the health insurance program.

Almost yearly since 1981, excepting for 1982, the government has lowered the medicine price standards–the yardstick for paying medicine prices under the national health insurance system. The combined rate of price reduction has reached 40%. The rate of reduction was 18.6% in 1981, 4.9% in 1983, 16.6% in 1984, and 6% in 1985. The insured, who had not needed to pay at all, are now required to pay 10% of the bill under the revised health insurance system which went into effect in October 1984.

Japan's output of medicines in 1984 totaled ¥4,027.9 billion ($19.6 billion), down from ¥4,032.1 billion in the previous year for the first decline since the end of World War II. The 1985 output was estimated to be about the same as the year before. The combined ordinary profit of 29 major pharmaceutical companies listed on the first section of the Tokyo Stock Exchange in fiscal 1984 was down by ¥24 billion from the previous year. The comparable fiscal 1985 figure was estimated to be about the same as 1984 at best. The government will likely lower the medicine price standards again in 1986. Depending on the size of reduction, the production value of medicines and the pharmaceutical companies' profits may fall below the 1985 levels.

Companies in other industries like chemicals and textiles seem ready to branch out into the pharmaceutical industry, on the strength of their improved biotechnology. The pharmaceutical industry, though facing possible deterioration in profit position, enjoyed a high 11 percent profit-to-sales ratio in fiscal 1984.

With some foreign firms also expected to enter the business, the Japanese pharmaceutical industry is headed for a severer situation. Some Japanese pharmaceutical companies may seek to merge or enter into business tie-ups with other Japanese or foreign firms in 1986. A reorganization of the industry will gradually proceed this year.

(Mitsuaki Tsuchiya, senior economist)

Fine, occasionally cloudy

## Foods

The foodstuff industry is a typical domestic and final consumer goods business which is affected largely by personal consumption expenditures.

While Japan's personal consumption showed an average annual growth rate of 5.6% in the three-year period from fiscal 1982 to 1984, the sales of the country's 51 major foodstuff companies, listed on the first section of the Tokyo Stock Exchange, registered an average yearly growth rate of 4.2% in the same period. Reflecting the maturing of the industry, its sales growth has been somewhat slower than personal consumption. Yet the industry is generally in a steady shape.

The 51 companies are expected to post an average sales growth at the 3 percent level in fiscal 1985, down from 4.6% in the previous year. The setback is due to such cyclical factors as the depressed market for edible oils, sugar, feedstuff and other raw materials, and a decrease in the sales of the alcoholic beverage industry, which accounts for 20% of the foodstuff industry's total sales, following a major price raise carried out in 1984.

The foodstuff industry as a whole will register in fiscal 1985 a higher profit-to-sales ratio than the year before. Despite the sluggish trend in sales, the industry's "upstream" sector will chalk up greater profits thanks to stable prices of raw materials and the yen's appreciation against the U.S. dollar in the latter half of the year.

Personal consumption is projected to increase by 5.0%–5.5% in fiscal 1986, about the same as for a normal year. The depressed market for raw materials like edible oils, sugar and feedstuff is likely to stop sagging. Barring unforeseen weather factors, the same 51 companies are expected to post a sales increase at the 4 percent level in fiscal 1986, somewhat higher than the year before.

The marketing of new food products will mean increased investment costs. However, the prices of raw materials are likely to remain relatively low and the yen's appreciation against the dollar will continue for some time. These will prove favorable to the industry, which heavily depends on imported raw materials. Overall, the 51 companies will be able to report greater profits than in fiscal 1985.

(Shuzo Haimoto, economist)

(electric power) Fine (oil) Rainy, later cloudy

## Energy

Global energy prices have been on the downhill in recent years amid the eased supply situation. Japan's energy demand decreased for three consecutive years from fiscal 1980 to 1982. Since fiscal 1983 it has turned upward and has grown smoothly in fiscal 1985.

While oil demand has tended downward, reflecting industry's all-out efforts to reduce its heavy dependence on oil, alternate energy such as coal, natural gas, and nuclear energy has come to occupy an increasingly important position, indicating that the nation's energy supply and demand structure is undergoing a major change.

Mirroring such a structural change in energy demand, electric power and town gas companies are likely to post their best profit yet in fiscal 1985, whereas oil companies are expected to suffer a net loss.

Electric power and gas companies have benefited from steadily increasing demand, the effect of using such alternate energy as nuclear power and LNG, sagging energy prices, and the yen's steep appreciation against the U.S. dollar. In stark contrast, oil companies have been hard hit by reduced demand mainly from industrial users and a sagging oil products market. Even the favorable effect of the yen's appreciation won't be of much help to them. This situation will continue into fiscal 1986.

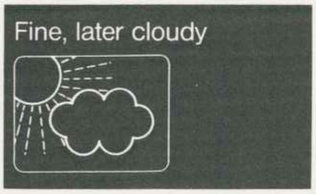
Demand for electric power and gas will probably show a slower growth than in fiscal 1985, due to general economic slowdown. Yet, the power and gas companies will continue to enjoy a favorable climate. If the yen rate remains high, energy import costs will decline further to the extent that the consumers will seek a cut in power charges.

On the other hand, demand for oil products will remain almost unchanged in fiscal 1986 as industry's efforts to switch over to alternate energy run their course. Given the yen's continued appreciation, oil companies' earning prospects will hardly improve. Regrouping of Japanese-owned oil companies, such as the merger agreement between Maruzen Oil and Daikyo Oil, will come to the fore. How to push the oil products market higher will be the foremost concern for the oil industry. As a result of the liberalization of gasoline imports, imports of oil products will increase in the months ahead, perhaps necessitating oil companies to dispose of their surplus refinery facilities. Indeed, the year 1986 will be a crucial one for the oil industry.

(Hideaki Saito, senior economist)

**Energy Demand Growth Rates (%)**

| | FY 1984 | FY 1985 (estimate) | FY 1986 (forecast) |
|---|---|---|---|
| Oil products | −2.4 | −5.3 | −0.1 |
| Electricity | 4.9 | 3.1 | 2.4 |




## Big Retailers

Sales at department stores and supermarkets have increased slowly but steadily since the latter half of 1983 when business recovery went into full swing.

Amid the consumer price stability, disposable income increased in 1985 thanks to greater pay and bonus raises, encouraging consumers to spend more on leisure goods and clothing. As a result, consumer spending was likely to show an appreciable increase in the year under review. Increased consumer spending on clothing, which came after many months of sluggishness, played the leading role in boosting sales at department stores and supermarkets. Most department stores are likely to post increased profits in 1985. Some of them will be able to show a marked improvement in their earnings performances. The industry is now emerging from the doldrums that began in 1983.

Supermarkets are likely to chalk up the highest profit yet in 1985. Conventional supermarkets have not fared very well in the face of intensified competition from fast growing convenience stores, and amid the relatively low prices of foodstuffs, which account for 44% of total sales. However, they are making up for the sluggish business by increasing sales at newly opened branch stores. They are also trying to reduce their inventories to the lowest possible level so that merchandise loss and loss resulting from changed price tags can be minimized. These efforts are proving successful and the supermarkets are expecting to post record profits in 1985.

In 1986, sales at department stores and supermarkets are not likely to grow as fast as in 1985 as general business activity, which began to show signs of a slowdown in the latter half of 1985, goes into a contraction phase.

In addition to slower pay and bonus increases and a drop in overtime pay, there are indications that consumers are becoming less enthusiastic about spending on clothing. Industry analysts fear that consumer spending on clothing may start falling considerably in the latter half of 1986.

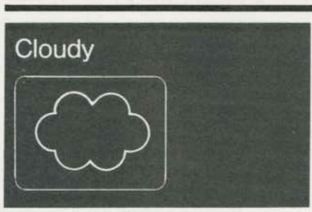
Against this backdrop, department stores will report only a slight profit increase in 1986, reflecting slower growth in sales. Supermarkets, though in the same business environment as department stores, will be able to report greater sales and profits as they switch to an integrated point-of-sales (POS) system.

(Toshio Nakanishi, economist)

**Sales Growth Rates of Big Retailers** (%)

| | CY 1983 | CY 1984 | CY 1985 (Jan.–Sept.) |
|---|---|---|---|
| Department stores | 1.9 | 3.5 | 3.9 |
| Supermarkets | 5.5 (1.9) | 5.1 (2.2) | 5.6 (2.6) |

Notes: Figures in parentheses denote the growth rate adjusted for store expansion; department store figures are based on data published by the Japan Department Store Association, and supermarket figures, based on data published by the Japan Chain Store Association.




## Construction

The Japanese construction industry may be in for another slack year in fiscal 1986 as little improvement in demand is anticipated.

Japan's construction demand has averaged about ¥50 trillion ($244 billion) a year, of which 60% is from the private sector and the rest from the public segment. Roughly half the private-sector construction demand is represented by housing investment and the balance by nonhousing investment, mostly corporate investment in capital equipment.

Since the two oil crises in the 1970s, Japan's corporate investment in plant and equipment has been generally at low levels. Housing investment has also tended to level off at 1.1–1.2 million starts a year since 1980, due to a sufficient housing stock and stagnant demand for new houses caused by the growth slowdown in the number of households. Government spending on public works projects has been held down since 1980 under the policy of fiscal reconstruction.

Japan's construction demand has thus tended to stagnate, forcing individual companies to scramble for limited orders from the private sector. This has led to a dumping race among them, resulting in poorer profit margins.

Demand from the private sector will not fare very well in fiscal 1986, picking up only marginally from the year before. Housing construction will grow by some 5% in nominal terms. Though the number of housing starts is unlikely to increase very much, the unit floor space of new houses will expand and their unit price will also go up. But construction demand from business corporations will tend to decline as they cut back on their investment in new plant and equipment. Prospects are far from bright for plant equipment investment by nonmanufacturing businesses.

In the government sector, no final budget for fiscal 1986 has been compiled. But the Construction Ministry has sought a 6% increase in public works spending for the new fiscal year. In view of growing calls both in and outside Japan for the promotion of domestic demand, some increase in public works spending may be forthcoming. Great expectations are placed on public works projects, which the government plans to launch with the help of relatively abundant private-sector funds. Particularly great hopes are pinned on such projects to be initiated by the Construction Ministry. However, none of these projects will help expand construction work in fiscal 1986.

The size of construction demand in fiscal 1986 depends largely on government public works spending, but no significant increase is expected in the new public works budget. The question is how much construction demand the construction companies can create in promising fields like urban redevelopment.

(Nobuo Fujii, economist)

**Construction Investment**

(¥ trillion; in nominal terms)

| FY 1984 | FY 1985 (estimate) | FY 1986 (forecast) |
|---|---|---|
| 48.7 | 49.3 | 50.6 |