# Small to Mid-size Companies Vulnerable

The strengthening of the yen in the first half of fiscal 1995 was a dash of cold water on recovering domestic demand for iron and steel, and its after-effects threw domestic demand into a slump. Prospects began to look bad for exports as well, as the tightening of international supply and demand due to the mid-year economic slowdown in Europe and the U.S. became more distinct in the second half of the fiscal year. Production of crude steel picked up in the first half of the fiscal year, principally because of increased production by electric furnace manufacturers anticipating higher demand following the Great Hanshin-Awaji earthquake. But the slump in the latter half of the fiscal year in domestic demand, coupled with an expected fall in exports to China and other countries, means that consumption will again fall short of the 100 million ton mark, reaching a total of only 99 million tons through the fiscal year. Although demand is expected to recover in fiscal 1996, exports are expected to drop. Production of unrefined steel will undoubtedly fall to about the 98 million ton level, the second year in a row that production will fall below the previous fiscal year.

The earthquake disaster and the strong yen sent tremors through the domestic market in fiscal 1995. Demand for steel bars did not revive after the earthquake, so the production increase in the first half of the fiscal year effectively depressed the market. Domestic demand for steel plates and sheets cooled off due to the impact of the stronger yen, and the sudden increase in imported materials swelled inventory; after the summer the market swung downward. Currently, as the inventory situation is remedied through lowered production, the market for steel bars has begun to improve; in steel plates, slow but steady adjustments to inventory are yielding signs of an end to the downward slope. With the imminent recovery in domestic demand, market conditions will hit bottom and then begin to improve. A true recovery of either market is unlikely, however, because of deteriorating international markets for plates and strong pressure on electric furnace manufacturers to increase production of beams.

Offsetting lower selling prices by cutting costs through restructuring, the five largest blast furnace companies are expecting windfall profits in fiscal 1995 of ¥240 billion, and all are expected to be operating without a deficit. But in fiscal 1996, though the effects of restructuring will continue to nudge profits up, higher prices for iron ore and coking coal may bring them back down, and further rationalization is expected to be necessary.

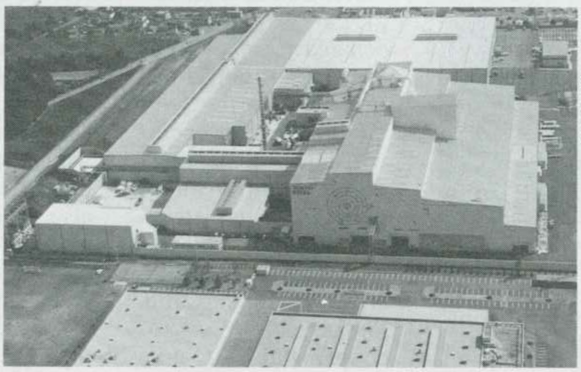

Photo: Tokyo Steel

*Tokyo Steel's Utsunomiya Factory operation in full swing from March 1996.*

Electric furnace manufacturers of ordinary steel are approaching a critical point. As iron and steel reserves accumulate in Japan, materials costs are relatively advantageous. But as the slump in selling prices lengthens, rising scrap metal prices will cut into earnings. To give an example, Tokyo Steel Co.'s Utsunomiya factory begins full-scale operations in March 1996, but the supply/demand outlook is tight, even in Kanto where there is a surplus of scrap metal. Given the abundance of electric furnace steel manufacturing projects in the U.S. and Southeast Asia, it seems likely that the international price of scrap metal will rise fairly high before leveling off.

Demand for construction, which absorbs 70% of products, is expected to go into a long slump, so one cannot hope for a real improvement in steel prices. As profits ceilings thus sink, the issue becomes that of how to chip away at fixed costs. Unlike blast furnace manufacturers, most electric furnace manufacturers are small to mid-size companies that are reaching the limits of restructuring and have seen profits decline for three years straight. Their internal reserves and liquid assets, accumulated during the bubble years, are running out. The sale of Soba Steel and the bankruptcy of Sanwa Steel are only two signs of the changing structure of the industry and the hard times ahead for electric furnace manufacturers of ordinary steel. JJTI

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**Crude Steel Supply and Demand** (Unit: 1 million t)

| | FY1994 | FY1995 (Estimate) | FY1996 (Forecast) |
|---|---|---|---|
| Domestic demand | 6.9% 82.7 | -0.2% 82.5 | 0.2% 82.7 |
| Exports | -3.1% 25.2 | -5.8% 23.8 | -5.2% 22.5 |
| Imports | 4.2% 6.6 | 10.3% 7.2 | 0.6% 7.3 |
| Production | 7.3 101.4 | -2.3% 99.0 | -1.1% 98.0 |

**Note:** Domestic demand shows net domestic consumption (production + imports - exports)
Note 2: Top left numbers indicate percentage change from previous year