

Earlier Moves Reap Positive Results

Accompanying the beginnings of the economic recession, domestic demand for petrochemical products continued to decline from its peak in fiscal 1990. But expectations are that fiscal 1994 will bring the first increases in four years, keeping pace with Japan's steady overall economic recovery.

Surveying synthetic resins—which accounts for 60% of domestic petrochemicals product demand—all varieties of general purpose resins experienced an increase in demand compared to the same month period the previous year in the first half of fiscal 1994. This was due to the fact that economic fluctuations had a relatively slight impact on demand related to individual consumption of film and other sundries, which has remained healthy overall up to now.

High levels of public sector investments and new housing starts sustained domestic demand support for pipe and construction materials, while improved demand for cars, home appliances, and electrical products finally yielded a gradual rebound for industrial component uses. Further, the hot summer and water shortages sparked special demand.

In response to the recovery in demand industries, there has been a reversion to positive growth compared to the previous year for synthetic fiber materials and synthetic rubber.

Petrochemical products supply and demand had been sluggish worldwide, but the underlying tone rapidly began to change in 1994. Continuing high economic growth in Southeast Asia has led to strong growth in demand for petro-

chemical products, while in China growing shortages due to plant troubles and other factors caused supplies to fall below forecasts and forced a substantial increase in imports at the beginning of 1994.

This resulted in a complete turnabout and tight supplies in Southeast Asian markets and spot markets rose rapidly. The tempo of price increases was particularly rapid from mid-year onward and the prices of many products have climbed 20% to 30% compared to the beginning of the year.

With rising prices the profitability of Japanese exports has improved in spite of the strengthening yen and, moreover, excess domestic facilities capacity for many products has led Japanese producers to enact a powerful export drive for



Photo: Showa Denko K.K.

Showa Denko K.K. and Nippon Petrochemical Co., Ltd. announce their operational merger.

styrene monomers, vinyl chloride resins, and other products. Under present circumstances fiscal 1994 exports are bound to exceed 1 million tons on an ethylene conversion basis, leading to expectations of record highs that will eclipse fiscal 1992.

Because domestic demand has rebounded and exports are increasing substantially, domestic production is again rising even though imports are on the rise. Demand growth for every type of derivative has yielded improved operating rates and fiscal 1994 ethylene production volume is expected to turn in 7.7% year-on-year growth, reaching 6.13 million tons.

The domestic market had been on a consistent downturn since the end of the Gulf War, but reached a turning point in 1994 when, although an underlying gap in supply and demand led to sales competition and prices continued to slide in response to alarm over cheap imports, mainly from South Korea, prices on global markets rallied. In other words, rising world market prices for chemicals, synthetic fiber materials, and other indistinguishable general purpose products led to a phenomenon in which import prices exceeded domestic product prices, resulting in more opportunities for industry acceptance of price increases and, although suppliers remained dissatisfied with prices as they were, the first price hikes since the 1990 era were achieved. The disparity between internal and external prices diminished, mitigating perceptions that domestic resin prices were too high and adding impetus to hike price negotiations to improve petrochemical manufacturers' profitability.

Petrochemical corporations' results are expected to rebound in response to these changes in the business environment, improving from the ¥62.7 billion loss in fiscal 1993 to a loss of ¥18 billion yen in fiscal 1994 in real terms. In contrast to a ¥28 billion loss in the first half, manufacturers are expected to be able to return to the black in the second half with profits of ¥10 billion when the effects of price increases appear.

The present petrochemical downturn does not merely derive from transient

cyclical causes. Instead, either in a wager for survival or the pursuit of still more growth, companies have implemented various restructuring efforts, recognizing that changes in the external and internal environment and the industry's structure also factor in.

Individual companies have on the one hand been withdrawing from unprofitable businesses or new operations started during the "bubble" period, cutting costs through personnel cuts and attempting to improve earnings, while on the other hand prioritizing management resources in core businesses and taking an aggressive posture overseas as well.

Further, mergers and agreements that transcend the limits of the individual corporation are increasing: Mitsubishi Chemical Corp., a merger between Mitsubishi Kasei Corp. and Mitsubishi Petrochemical Co., Ltd., started up in October 1994; Asahi Chemical Industry Co. and Showa Denko KK agreed to exchange their polypropylene and polystyrene operations; Nippon Zeon Co., Ltd., Sumitomo Chemical Co., Ltd., and Tokuyama Corp. will combine their vinyl chloride businesses; and Showa Denko and Nippon Petrochemical Co., Ltd. will join their polyolefin operations, implementing measures previously unheard of.

Future outlook

Surveying fiscal 1995 domestic demand trends by sector, consumer demand can be expected to rebound due to the economy's overall buoyancy. As public and housing investments are expected to continue at high levels, shipments to these sectors are also expected to remain satisfactory. On the other hand, industrial component demand recovery is expected to remain subdued due to the repercussions of "hollowing out" upon primary users, special demand related to the hot summer and water shortages has dissipated, and, moreover, film and sundries are increasingly being imported from Southeast Asia due to lower labor costs. Therefore, rapid overall domestic demand expansion will be difficult, leading to expectations that fiscal 1995 ethylene conversion will only increase

to 5.64 million tons, about 1.7% more than fiscal 1994.

Continued petroleum product demand is anticipated in Asia and it is believed that market conditions will permit Japanese manufacturers to continue to maintain profitable export levels. As such, fiscal 1995 petroleum product exports should hold at about the previous year's levels, and production should continue to depend on exports.

Under these circumstances, the price increases implemented during fiscal 1994 are expected to contribute to fiscal 1995 corporate results throughout the fiscal year while reductions in fixed costs and other expenses should permit the top six companies' actual ordinary profits to top fiscal 1994 by ¥51 billion and obtain ¥33 billion in profits for the entire fiscal year. However, assuming 50% corporate tax deductions, the top six firms require ¥61.4 billion in total ordinary profits for a 10% dividend and the preceding fiscal 1995 profit estimate anticipates that it will only be a bit more than half of this figure.

The petrochemical industry's fiscal 1995 business climate will likely be more favorable than the previous year internally and externally. Considering the maturity of Japan's economy, 1.7% is a fairly good figure for domestic demand growth, export volumes will be maintained at their highest levels ever, and price levels will ensure adequate profits, in contrast to 1991-93, when exports were maintained at the expense of the domestic market. If in this environment profit levels that permit dividends to be issued are not attained, as note in the above fiscal 1995 earnings estimate, the industry will likely be faced with the issue of continuing cost cuts to improve profitability.

In fiscal 1994 companies took resolute, previously unseen steps to restructure on the individual corporate level and between companies, and these moves should further accelerate in fiscal 1995. In that sense, as noted above, fiscal 1995 will be a year in which the petrochemicals industry and companies must respond to the issues. ■

(Yokoo Hisaaki, senior economist)