Increased Profits Seen for FY97

Recent trends

Gentle expansion in domestic demand

Domestic demand for petrochemical products (calculated here and elsewhere based on ethylene demand) for fiscal 1996 was predicted to have increased by 2.3% over the previous year for an all-time record high demand of 5.88 million tons. The previous record, at the height of the bubble economy in fiscal 1990, was 5.83 million tons.

In resins, which account for around 60% of domestic demand for petrochemical products, domestic output of the five major all-purpose resins varied widely. While domestic shipments of PS (polystyrene) in fiscal 1996 looked like they would have reached approximately the same level as last fiscal year, domestic shipments of the other four were expected to have topped last year's figures, with PP (polypropylene) heading the list.

Petrochemical product demand can be divided into three major categories: products used in everyday life, industrial parts and civil engineering and construction. Demand was weak overall in the industrial parts category due to hollowing out of the assembly processing industry, which is the major client for industrial parts. The consumer life-related category, however, provided the engine for growth in resins demand, particularly in the trend toward individual packaging. Individual packaging, widely used in the packaging of sweets and other food items, refers to the practice of individually wrapping each item within a larger package. Demand in the civil engineering and construction category also developed a bullish tone due to a year-on-year increase in public works projects and the jump in housing starts caused by a beat the coming consumption tax hike.

While the increase in domestic shipments of raw synthetic fiber was expected to have held steady with the previous year's figure, synthetic rubber shipments appeared to have been trending upward, having benefited from healthy tire production.

Exports remained in good condition

The international petrochemical products market held a bullish tone for approximately one year from early 1994 until May-June 1995, followed by a retreat that lasted until early 1996. Since then the market has been uneven, reflecting the differing supply and demand conditions surrounding individual products. Overall, however, the market is holding steady at a level higher than that of 1993, just prior to the steep rise. Furthermore, the exchange rate is moving into a correction period, with an average rate of 110 yen to the dollar in 1996 compared to 96.5 yen in the previous fiscal year. This works to the advantage of exports.

In this environment, exports have remained healthy since the second half of fiscal 1994. An all-time high of 1.81 million tons of exports is forecast for fiscal 1996, a 12% increase over the previous year. On the other hand, imports were expected to have remained at around the previous fiscal year's levels.

Production hit all-time high

Domestic production has done well in the face of higher domestic demand and a better export/import balance. Ethylene production, thanks to a favorable market for derivative products, was expected to have grown by 3.7% over the previous year to around 7.21 million tons, a new all-time production record. The plant operation ratio rose to over 98%, representing essentially full capacity.

Corporate profits spotty

In the past petrochemical companies generally kept pace with one another in the area of profits, but settlement accounts in fiscal 1996 were expected to have revealed a greater disparity in profits among companies due to variable market conditions for the mainstay products of different companies. While profits overall were expected to fall, some companies were expected to have had profit growth.

Prices for many petrochemical products have fallen below last fiscal year's prices because of the decline of the international market. Prices for PTA (purified terephthalic acid) and SM (styrene monomer), in particular, having skyrocketed during the market upswing during 1994 and 1995 when the market was brisk, are now greatly dropping. Despite the recovery of domestic prices of all-purpose resins in the early spring of 1996, prices for commodity plastics overall were weak. Finally, prices began to rise in October, building to a price increase of ¥5-15/kilogram. Despite variation among different resins, average prices for the year overall were expected to have been around that of the previous fiscal year. The fall in profits accompanying falling prices—including in the non-petrochemical fields—is forecast at around ¥30 billion.

At the same time, raw naphtha prices rose sharply due to the rise in the crude oil market and the falling yen and the six major petrochemical corporations were expected to have experienced an increase in naphtha costs of about ¥63.5 billion.

Standing against these falling profits (which total around ¥93.5 billion) the Big Six foresee ¥35 billion increase in profits from increased sales volume and another estimated ¥46.5 billion coming from an improved financial balance linked to reduced loans and low interest rates and from rationalization measures. For the Big Six companies, this leaves a total profit loss of around ¥12 billion. Actual ordinary income (ordinary profit excluding income from sales of valuable securities figured as non-operating income) was expected to have reached around ¥81.6 billion.

While the petrochemical field will see sizable declines in profits, the fine chemical field, where export ratios are high, will see increased profits from the cheaper yen. The new business fields that petrochemical companies have been pouring energy into in recent years—primarily the electronic information field—are also contributing more to total profits.

Companies continue to pursue restructuring in hopes of cutting costs. In the area of all-purpose resins, where the entire industry has been losing money, business tie-ups between companies continue to occur frequently just as in fiscal 1995.

Outlook for the future

Low growth in domestic demand

The actual GDP growth rate is expected to drop below 1% in fiscal 1997 as the public investments which have supported Japan's business environment up until now fall off and domestic private demand fails to recover without intervention. Domestic demand for petrochemical products, as well, is expected to reflect the overall economic trend and see an overall growth of only around 1.0%.

Reduction of import/export balance

Beginning in 1998, many new facilities are expected to go on-line in Asia and the Middle East. Consequently, chances are good that the supply/demand ratio will worsen for Japanese petrochemical companies and the Asian market will decline from 1998. In 1997, however, a major drop is not expected as long as demand growth in China and the rest of Asia maintains the same pace in 1997 as during the past several years.

Exports from Japan in fiscal 1997 are expected to remain at their present high level, but exports of SM in fiscal 1997 are expected to fall below 1996 SM exports, due to SM production start-ups in plants in other parts of Asia, putting expectations for all exports at 3.8% lower than the previous year.

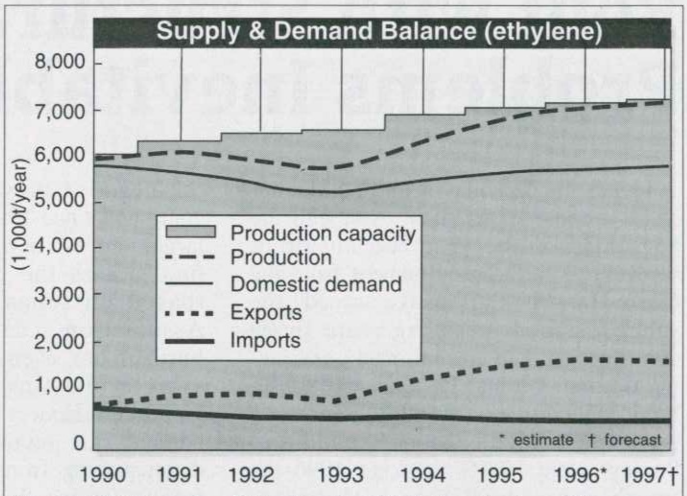
On the other hand, with an expected slight increase in imports, the export over import balance is expected to fall to 1.25 million tons in fiscal 1997, a 85,000-ton drop over fiscal 1996.

Continued high plant operations in ethylene production

While domestic demand will see only low growth, the decline in the balance will cause a 0.3% drop in ethylene production, for an estimated 7.18 million tons of production. However, with an operation ratio at the 97% mark, factories are expected to be just as busy as in fiscal 1996.

Increased profits forecast for fiscal 1997

The price of raw naphtha in fiscal 1997 is expected to be around 1,000 yen/kiloliter lower than in fiscal 1996 due to falling crude oil prices. Although domestic prices of petrochemical products are expected to fall slightly in the second half of this fiscal year, petrochemical companies are expected to hold on to part of the margin gained from lower raw material costs. Furthermore, earnings of the Big Six are expected to increase by around 15 billion yen over the previous year to around 96.6 billion yen. The increase in profits will come from the cost-cutting part of restructuring and increased profitability in the non-petrochemical sector.



Source: IBJ, based on Petrochemical Statistics, Customs Clearance Statistics

Necessary responses to globalization

The petrochemical industrial sector used to have a strong domestic orientation, but over the past decade the environment surrounding the industry has changed greatly. The era when companies could do all their business within Japan's borders is passed. Today, the overseas market has taken over an important position.

In the midst of this trend, every petrochemical company is planning and implementing overseas production in other parts of Asia in various core business areas. It has become routine for Japanese companies to build most of their new facilities for production of all-purpose products outside of Japan in other parts of Asia. Currently, the average overseas production ratio of Japan's major petrochemical corporations is around 8%, but if the plans currently coming down the pike are implemented, that ratio will definitely surpass 10% in the near future.

However, because the current overseas expansion is centered on all-purpose products, there are fears that this strategy could burden the industry in a period of flagging demand and supply. Thus, in terms of marketing—an area which used to be left to the trading companies—Japanese petrochemical companies must earnestly attempt to create sales networks in Asia to target local demand and increase their marketing prowess. These kinds of strategies are necessary to ensure a smooth start-up of their overseas operations.

Even if the center of the petrochemical industry is destined to gradually shift overseas, the strengthening of the domestic industry must continue—for two reasons. First of all, just as in the past, domestic operations must be relied on as the basis for petrochemical companies' profits. Secondly, exports are already built into the production system, so exports cannot be decreased. In short, the high cost structure that came from the aggressive expansionary strategy of the bubble economy means that the Japanese petrochemical industry requires plant operation ratios exceeding 90% in order to turn a profit. If exports were to fall to half present levels, however, the operation ratio for ethylene production would drop 12% to 86% and income and expenditure would once again become unbalanced. Currently, exports are not the marginal outlets for maintaining the domestic operation ratio as was the case in the 1980s. Rather, exports now occupy a vital position in the structure of the petrochemical industrial complex.

Consequently, in order to strengthen the profitability of domestic business operations and in order to maintain current export levels, the petrochemical industry must reduce costs of all-purpose items and also encourage a shift towards high added-value products.

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