

Clamoring to Ride the Asian Market to Profits

Recent conditions

Stagnating domestic demand

Reflecting the economic slump, the expected year-on-year increase in domestic demand for petrochemical products for fiscal 1995 was only 1.6%, a total of 5.72 million tons in ethylene conversion.

Growth in demand for synthetic resin, which accounts for 60% of demand for all petrochemical products, peaked in February-March 1995 as measured by domestic shipping of the five major all-purpose resins. This rate subsequently dropped to a low in August-September 1995, then recovered. For the year, however, growth was expected to be only slightly higher than in fiscal 1994.

Domestic production of raw materials for synthetic fibers is expected to reach the same level as in fiscal 1994, and domestic shipments are likewise stable.

Synthetic rubber, which is principally used for automobile tires, is increasingly being exported to Asia to meet demand created by the popularization of vehicles in the region. On the domestic front, tire production emerged from its slump due to strong demand for repair tires, and FY 1995 tire consumption is expected to be substantially higher than FY 1994. Domestic synthetic rubber shipments are also seeing normal increases.

Good conditions for exports continue

International supply and demand for petrochemical products, reflecting the strong global economy, rose in all regions since early 1994. Growth in demand outpaced supply capacity, tightening supply and jolting the market out of the slump that had held since the Gulf Crisis. The sudden jump in price kept Japan's petrochemical exports high in the first half of fiscal 1995, despite the strength of the yen.

The Asian market was saturated by May-June 1995, however; supply capacity within Asia had grown and the

economic slowdown in Europe and the U.S. had prompted petrochemical manufacturers there to step up exports to Asia. The final blow was dealt by China's implementation of stronger tariff regulations in May-June 1995, pushing the market into an adjustment phase. Although exports will shrink during the second half of the year, the year's exports as a whole are expected to reach a historical high of 1.58 million tons (ethylene conversion), more than twice that recorded in fiscal 1994.

Export-driven rise in net rate of operations

Despite stunted growth in domestic demand, a greatly improved balance of trade stimulated domestic production.

Since the end of 1994, when Keiyo Ethylene (Chiba) began operation of its 600,000 ton facility, domestic production capacity had reached 7.2 million tons. Production of chemical derivatives progressed normally, and a high level of raw ethylene exports kept the operations rate up. Production was headed for a 6.1% increase over fiscal 1994, for a record high of approximately 6.87 million tons.

Recovering corporate profits

Chemically synthesized products are seeing a price increase on the domestic market, following that on the international market. Resin remains less than profitable, however, even after a price hike in the second half of 1994, and petrochemical manufacturers want to raise the price still further. Such an event is unlikely because of excessive competition for weak domestic demand and strong resistance on the part of resin-using industries.

Higher production and higher prices compared to fiscal 1994 ensure a substantial increase in profits for petrochemical companies. Exports will rise in quantity but also in price, contributing greatly to the recovery of profits. Shrinking costs, an improved financial

situation due to a drop in interest rates, and smaller repayments because of recent restraints on investment in plants and equipment will further contribute to the balance of payments of the six largest companies, which should improve by ¥100 billion over fiscal 1994. This will mark the first time in three years these companies will see a surplus of payments on an actual basis (excluding profits from sales of securities).

Mounting inter-company alliance in the all-purpose resin field

Since 1992 or 1993, petrochemical companies have been restructuring—down-sizing or eliminating unprofitable sections and slimming down management. In fiscal 1995, companies began to cooperate with one another. All-purpose resin manufacturers have made particularly concerted efforts, disbanding all cooperative-selling companies of polyolefin and breaking the hold of cooperative selling over chloroethylene.

Future Trends

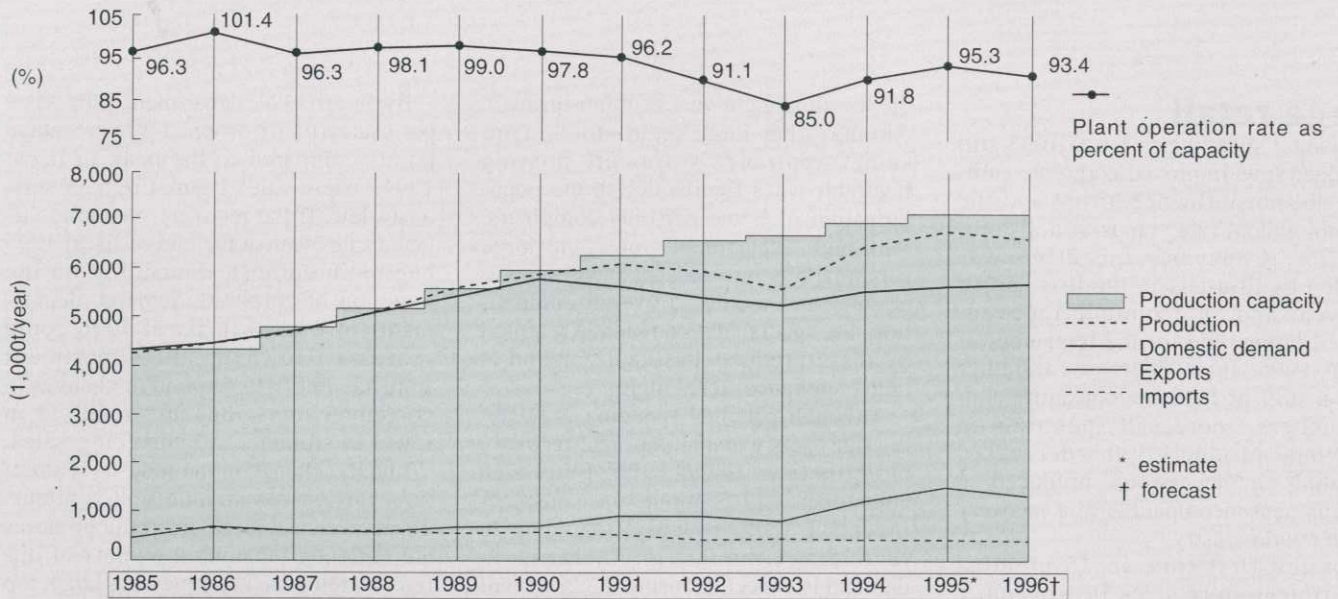
Slow growth in domestic demand

Fiscal 1996 should see steady economic improvement as the year progresses, stemming from public investment and other economy-stimulating policies, and from the impact of heightened demand prior to April 1997 when a consumer tax hike will take effect. The demand for petrochemicals should likewise expand with time, but because GDP growth is estimated at only about 1.5%, growth in domestic demand for petrochemical products is also likely to be slow.

Reduction in export/import balance

On the international front, discrepancies of supply and demand for different products will become more pronounced. For most products, newly operating facilities in Asia and the Middle East, and a predicted increase of inflow of products from Europe and the U.S. will

Supply & demand balance (ethylene)



Source: Petrochemical Statistics, Customs Clearance Statistics

ensure continued growth in demand. But in the absence of a tight supply/demand outlook, market conditions will continue at their lower, 1995 levels, and the absolute shortage of supply capacity for certain petrochemical products will continue to keep those market conditions stagnant.

Notwithstanding the unpredictability of such factors as the U.S. economy and Chinese trends, the kind of export windfall that occurred in the first half of fiscal 1995 cannot be expected to occur naturally. On the other hand, export/import positions should decrease due to the expected increase in imports.

Ethylene production headed lower

Supported by exports, the manufacture of some synthesized products will continue at full tilt in fiscal 1995, but as Asia's shortage abates there will be general decline in exports of derivatives. Though the increase in domestic shipping seen in fiscal 1995 will continue, domestic production will fall off, and ethylene production is expected to see a 1.7% decrease—to about 6.75 million tons—from fiscal 1995 levels.

Deteriorating environment for earnings

Production is decreasing. On the price front, the international market is falling as are export profits, and prices for some products on the domestic market, principally synthesized products, are being pulled down by lower international prices. For these reasons, the earnings environment in fiscal 1996 will be harsher than in fiscal 1995. It is predicted that petrochemical companies will fight back by reducing costs, but it will not be easy to attain profits that exceed those recorded in fiscal 1995.

Reversing deterioration in business environment

Since fiscal 1994, the world's petrochemical industry has been blessed by a good environment, but the current situation will not last forever. After 1994, when it seemed guaranteed that the market would continue to improve, many more facilities were planned for Asia and the Middle East, to begin operation in 1997. As the supply/demand outlook for all-purpose resin loosens, the market may drop further.

To secure profits even in such low-market times, fixed costs and other domestic costs must be reduced even farther. As mentioned above, all-pur-

pose resin, the most problematic of domestic sectors, has fashioned an alliance that separates joint venture businesses in order to attain merit of scale. In fiscal 1996, these efforts will begin in earnest. How well companies will succeed while maintaining ties with their investing parent company in terms of raw materials, personal relationships and other aspects will depend on their skill, and is an important element in forecasting the future of domestic petrochemicals.

Foreign development—how well demand in Asia can be harnessed in particular—will be an important topic for Japan in fiscal 1996. Petrochemists have moved aggressively into Asia in recent years, and European and U.S. makers also have their eyes on expanding their presence there. Asian market capital is dynamic and high-growth, and we can expect that competition for the Asian market will intensify.

The true worth of Japan's petrochemical industry, which is not as strong or as experienced in overseas business as those of Europe and the U.S., will be determined by whether it can ride on the Asian market into the 21 century.

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