

The Japanese Economy In 1995

Economy bottoms-out, but recovery weak

After hitting bottom in October 1993, the Japanese economy is now entering a period of slow recovery ushered in by an increase in the real purchasing power of consumers, which in turn can be traced to lower consumer prices, lower interest rates and tax cuts. With falling land prices and interest rates stimulating demand, investments in housing picked up early on. Now demand for audio-visual equipment has also accelerated as an increase in reverse imports brings the price down. The automobile industry is also turning toward recovery, spurred on by a rise in disposable income due to tax cuts.

A favorable business climate abroad has also contributed to Japan's recovery. Semiconductor exports have been strengthened by aggressive investments in information-access development, the downsizing trend and increasing production of household electrical appliances in Asia. The worldwide recovery has invigorated steel and petrochemical exports. Total raw steel production for fiscal 1994 is estimated to reach 100 million tons and ethylene production is

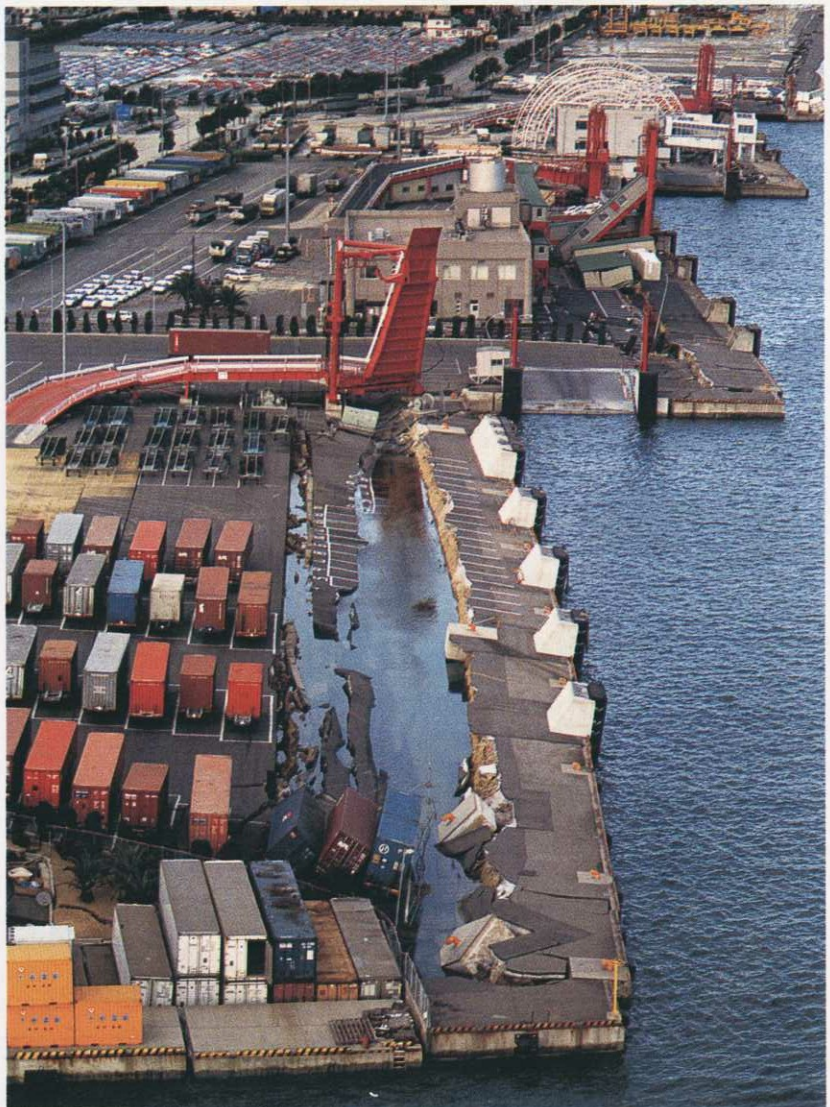


Photo: Kyodo News Service

thought to be 6 million tons. Public investments have propped up the demand for cement and petrochemical products and have also helped bolster the demand for machines and equipment used in civil engineering projects.

Meanwhile, plant and equipment investments in the private sector continue to stagnate, slowing improvement of the business climate. Both the assembly and raw materials industries are overburdened with production equipment surpluses due to the maturation of the domestic market and the transfer of production to overseas factories. These same factors appear to be holding down investments in increased capacity. Few sectors—save semiconductor manufacturers, which have benefited from the downsizing trend, or telecommunications equipment, where expansion of the telecommunications market is expected—are forecast to experience growth in demand in the future. Those that are expected to grow still do not have much potential to boost overall plant and equipment investments.

Loss-profit balance finally on plus side

After a fall in profits during all four quarters of fiscal 1994, the balance of income and expenditures (based on data from major corporations) is anticipated to finally experience an upswing. Looking at individual industries, increased sales in the electronics and electrical equipment industry was aided by a boost in semiconductor exports while the automobile industry was assisted by stronger domestic demand. In addition, restructuring has been effective in both industries and is expected to bring a broad increase in profits. Regarding materials such as steel, petrochemicals and cement, domestic demand hit rock-bottom in the first half of 1994, leaving no where to go but up.

In the non-manufacturing sector, on the other hand, supermarkets will experience inevitable losses, being unable to cover lower prices brought about by price busting with increased sales volume. The construction industry will experience huge losses due to a decrease in contracts and completion of

low-profit projects.

The strong yen took a heavy toll on fiscal 1994 business balance sheets. In the automobile industry, for example, approximately 40% of vehicles produced are for the export market and over half of these are thought to be paid for in foreign currency. Countering losses in income from the strong yen by raising prices will be difficult; every one-yen rise in the exchange rate is estimated to cut the total profit of the automobile industry by about ¥40 billion. Meanwhile, among industries that benefit from a higher yen, the electric power industries are temporarily reducing prices, and oil companies are enjoying high-yen gains related to usance bills for petroleum and crude oil imports. The scale of these profits is relatively small.

In this harsh business atmosphere, restructuring measures in the manufacturing sector continue to be effectual. In addition to shrinking fixed costs, the assembly industry is finding success with cost-price reduction activities such as cutbacks in temporary workers, universality of parts and combination or elimination of some products. Consequently, the proportion of variable costs is in a downward trend. In the raw materials industry, fixed costs, mainly personnel expenses, continue to be pared down. Companies are planning to aggressively push further restructuring.

Extremely slow recovery

Disposable income levels are expected to be maintained in fiscal 1995 by continued tax cuts. Personal consumption is expected to show a steady pace. Still, the income and employment environment is not healthy and a genuine recovery of consumption levels will surely take time. Furthermore, rising interest rates are expected to cut back on housing investments. Plant and equipment investments are also expected to remain low. There is also a real possibility that the U.S. economy will stagnate and hurt the export market. Therefore, although the economy is on the road to recovery in fiscal 1995, the pace of the recovery is expected to be

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

Notes: 1. Years are calendar year unless specified.
2. The fiscal year is from April to March.
3. Figures and tables provided by the IBJ unless specified.

extremely slow.

Due to the slow pace, the balance of revenue and expenditures (for major companies) will probably come out with only slight profit. The manufacturing industry will secure large profits from the rejuvenation of domestic demand and the fruits of restructuring, but chances are that the non-manufacturing sector, influenced by losses suffered by large construction companies, will end up with slight losses. Industry-wide profit levels are not anticipated to even reach 50% of levels recorded in fiscal 1989, when they were at their highest, making for an atmosphere that does not feel much like a recovery.

Effects of the Kobe earthquake on industry

Many precious lives were lost in the earthquake that struck southern Hyogo Prefecture, and over 100,000 homes were destroyed. It will take much time for the lives of the victims to return to normal.

The earthquake also caused widespread damage to industrial infrastructures, such as Kobe Port and expressways, and to factories located in the area. There is concern over what effects this damage will have on Japanese industry and the Japanese economy.

Factories in Hyogo Prefecture account for less than 5% of Japan's total manufacturing output. Thus, only a few industries are thought to have suffered from major damage, such as an inability to obtain supplies. However, there is some concern that the tight supply and demand for plywood and steel materials will lead to higher market prices. Furthermore, some supply problems are



Photo: Kyodo News Service

Despite the intervention by the BOJ through intermittent dollar purchases and yen sales, the yen soared to ¥80 on the Tokyo foreign currency market in April.

expected in goods from industries such as synthetic leather shoes and saké where Hyogo Prefecture holds a large share of production. In the assembly industry, problems in parts procurement may crop up in unforeseen places, depending on the amount of damage at secondary and tertiary parts manufacturers. There are also concerns that problems with the distribution system in the Hyogo Prefecture area will raise distribution costs for companies.

As a distribution center, Kobe Port handles 30% of the nation's container shipments. However, the large-scale container terminals on Rokko Island and Port Island were essentially demolished in the quake, doing major damage to Japan's import and export capabili-

ties. If Kobe Port is not rebuilt quickly, Japan will lose ground in its ranking as a distribution center as new transport routes are secured with Pusan Port, for example, as a reshipment hub.

The swift rebuilding of fallen housing and damaged infrastructures is called for as are immediate measures to help industries meet demand.

Focus on Japanese economic issues

One result of the two-and-a-half-year-long recession was to focus attention on structural issues within the Japanese economy. The first issue is the changing structure of Japanese industry. In the automobile and home electrical appli-

ance industries, the rising yen accelerates the shift to overseas production while at the same time the domestic market continues to mature. Maturation of the assembly industry has brought the domestic market for materials to a standstill, while also bringing about an oversupply of production equipment and manpower. Future growth in a smattering of industries, such as the information and telecommunications fields, is expected, but at present they have not grown enough to stand shoulder-to-shoulder with Japan's leading industries.

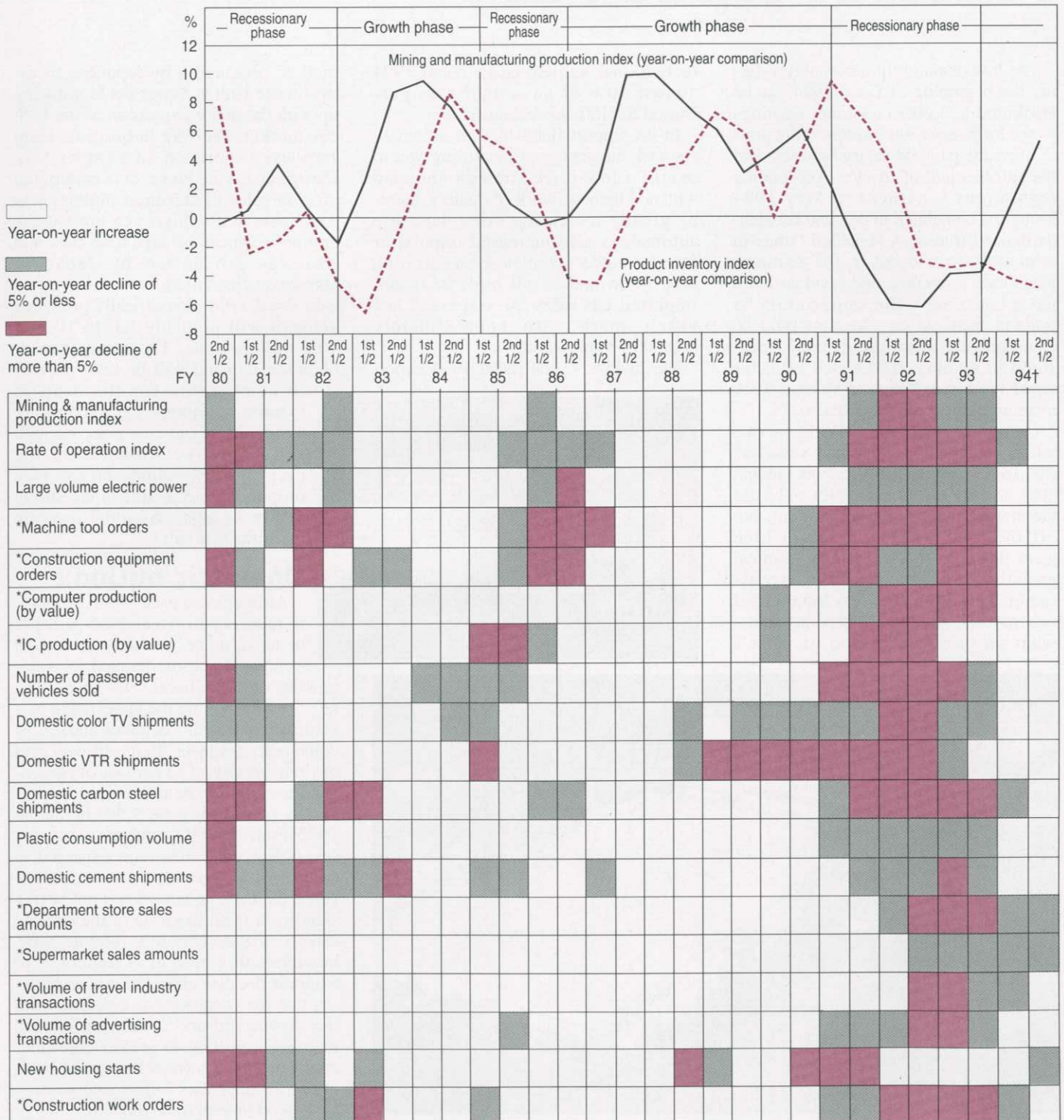
The second issue is readjustment of the product price range through practices such as "price busting." The downward adjustment of Japanese prices—caused by the arrival of the "age of major competition," the wide disparity between domestic and foreign prices and changing consumer behavior—is expected to continue for some time. It is hoped that the upshot will be higher real purchasing power for Japanese consumers. On the other hand, if businesses cannot hike sales volume enough to offset lower prices, falling profits may be translated into lower wages for employees.

In order to secure stable growth for the Japanese economy, the principle of competition should be allowed to reign free in the non-trade goods sector in order to reform Japan's high-cost tendencies and increase the competitiveness of Japanese industry. Furthermore, regulations that inhibit the expansion of new markets should be relaxed and growth of new industries should be promoted. The appearance of a view that there is a surplus of workers, until now coddled by government regulations, is of concern. To address this, it is vital that social policies, such as policies to increase the fluidity of employment, be implemented simultaneously with deregulation. For the future development and competitiveness of Japanese industry, we must break the chain of vested rights and interests and implement deregulation, with full understanding that there will be some accompanying pain. ■

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Industrial and Economic Outlook

For manufacturing industries, most indices are recovered in the first half of 1994



Notes: *Denotes value, others show volume. †Denotes estimate