

# T he Japanese Economy In 1996



## Meager Hope for Growth in fiscal 1995

The economy has shown signs of a recovery since it hit bottom in October 1993, but the pace has been quite gradual.

As the benefits of tax cuts dissipated, housing investments peaked, and other signs of a resurgent economy began to evaporate at the beginning of 1995, the Kobe earthquake and other unexpected developments hit consumer confidence like a bucket of cold water.

The yen's rapid appreciation from March onward had particularly serious repercussions. Because companies accelerated cost-cutting as the import-export balance worsened, anxiety over earnings and employment has not been eliminated. Conditions in sectors linked to individual consumption are harsh as a consequence and the additional impact of a "price collapse" has led to indications of an extended negative tone in department store and



supermarket earnings. Housing starts also shifted sharply downward in the first half of fiscal 1995.

Hopes for a rebound were also faint in other industrial sectors. Domestic demand grew in some sectors, such as the automotive industry, which garnered benefits from new car purchases, petrochemicals, which gave signs of a recovery based on benefits from economic stimulus measures, and cement, but growth lagged in most sectors. The export slump caused by the strong yen and rising penetration by imports served as additional factors in dragging domestic production down, making a recovery appear even less likely. Even in the electronics and electrical equipment sectors, where domestic demand was quite robust, surging imports exceeded domestic demand by a ratio of over 20% and manufacturing growth lagged behind the expansion in domestic demand.

On the other hand, forecasts are that in fiscal 1995 private sector capital outlays will have increased for the first time in four years. In the electronics and electrical equipment sectors, investment in production facilities for key devices has picked up, and the telecommunications sector boosted investment in response to the upsurge in cellular phone subscribers. Although the numbers appeared to indicate that most other sectors were making advances, investment was concentrated on maintenance and replacement, with little expenditure on increased capacity, and, because facilities investment flowed abroad in conjunction with an increase in overseas production, the gains lacked strength. Further, mid-size and smaller companies' capital outlays have yet to recover due to the repercussions of major corporations' cost-cutting measures.

### **Improved earnings, but optimism lacking**

Although revenue and expenditure at leading corporations remained mixed in every sector in fiscal 1995, it is forecast that profit growth will match that of fiscal 1994.

In non-manufacturing industries, along with department stores, which will again see a drop in profits due to the impact of

the earthquake combined with a continuing lag in demand, the real estate industry will inevitably experience sharply reduced profitability stemming from an oversupply of condominiums and flat office property rentals.

On the other hand, manufacturing industries are expected to turn in generally favorable results. In materials industries the steel industry has returned to profitability by compensating for slow domestic demand with progress in restructuring, while the petrochemicals and pulp industries were blessed with a favorable combination of advances in restructuring and healthy international markets, respectively producing substantial growth and trebling year-on-year profits. The automotive industry offset stagnant exports brought on by the strong yen with strong sales in Japan and slashed subcontracting and other variable costs. Despite price reductions in the electronics and electrical equipment sectors in Japan and elsewhere, demand increased broadly, leading to expectations that their respective profits will grow by around 30%.

Naturally, since manufacturing industry profitability is the primary factor in assuring continued overall corporate earnings growth, low profit levels (about 50% of record highs) and ongoing corporate restructuring indicate that conditions are such that companies for which improved profitability will be linked to increased capital investment and additional employment will inevitably be in the minority.

### **Industry trends indicate continued slow growth**

Although the economy will continue to recover in fiscal 1996, the pace of the upswing will remain gradual.

Based on the premise that the exchange rate stabilizes at current levels, corporate (leading companies') earnings should continue to rise, mainly due to improved export profitability in the automotive, electronics, and electrical equipment sectors, yielding three consecutive years of increased profits, but companies will retain their cautious approach. Fiscal 1996 capital expenditure plans have been scaled back and a bit more time will be needed

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

before corporate sentiment regarding the economy regains more optimism.

This leads to anticipation that an improved environment for wages and employment will remain gradual, and it is thought that for the time being not much strength can be expected in recovering consumption. With lower interest rates and an additional burst of demand in advance of a consumption tax increase in fiscal 1997 housing starts are forecast to exceed those of 1995, but if panic buying factors are excluded demand will lag at levels lower than fiscal 1995.

### **By industry, few sectors show clear indications of a recovery**

Expectations are that the U.S. economy will run out of steam and that increased exports will produce softness in Asian markets, resulting in abruptly declining exports and a reversion to negative domestic production growth for the petrochemicals industry, which achieved record export volumes in fiscal 1995.

The real estate market's prolonged slump will also undoubtedly continue in fiscal 1996. A recovery is anticipated in neither the subdivided condominium market, plagued by a slowdown induced by excess supplies, nor the office market, in which there is no expectation that demand for space will revive. Land price trends do not appear optimistic, either.

On the other hand, although lackluster internal and external demand for TVs, videocassette recorders and other home-use products is expected in the electronics and electrical equipment sectors, it is anticipated that the electronic components sector will be favorably sustained by the benefits from the worldwide boom in investment related to computers and multimedia, and that the market's new focus will lead to steady growth.





Construction start-ups will meet projections but won't stretch beyond last year's mark.

## Emerging shape of Japanese industry's structural changes

Under current conditions, Japanese industry, particularly the manufacturing sector, finds that there are few ripple effects when a company raises capital expenditure after profits increase, and that a recovery in domestic demand does not necessarily go hand in hand with increased production. The difference in internal and external price structuring has been the main factor in this situation, along with the "hollowing out" of industries and collapsing prices.

Trade-dependent industries have been unable to sustain rising domestic production costs and many different sectors have increasingly shifted production overseas. If this continues it will inevitably lead to industrial hollowing out.

On the other hand, consumers have welcomed the cheaper imports produced by the yen's appreciation and this has led

to downward price pressure even in sectors in which price arbitration had not previously been applied. The price destruction trend has had positive aspects, improving consumers' real purchasing power and generating growth industries, and is spreading to more and varied sectors.

Although Japanese industry is beginning to recover, interim growth will inevitably be restrained and there are no expectations for now that the strong yen and other factors in this can be eliminated. It should be noted, however, that attention must be paid to the effects of structural changes, which have steadily begun to become apparent, along with cyclical factors, in the current stagnant industrial climate.

This is to say that, due to production costs that are far higher than international standards, the existence of exhaustive regulations and other factors, Japan's attractiveness as a location for manufacturing has been sharply diminished and it can be said that Japan's

social structure is at the root of the loss of global competitiveness.

From here on structural changes will surface in various forms. Abrupt changes in Japan's demand structure are foreseen due to an aging society, slowed population growth, and the satiety with material goods, among other reasons, and advances in multimedia and the advent of an age of "mega-competition" will greatly alter the industrial structure.

However, the structural factors that have produced the current delayed recovery and future structural changes will induce reforms in most sectors of Japanese industry, and from this perspective there is hope that progress will be made in transforming Japan's industrial structure, creating opportunities for new industries to grow.

It can be said that, to eradicate Japan's leading industries' pessimism regarding recovery and maintain stable economic growth in Japan, radical reforms of social structures, focusing on deregulation, must be undertaken to help these facets materialize.

Above all, attention will center on the effects of deregulation. First, this will contribute to reduced costs for trade-oriented industries by sparking competition among industries dependent upon the domestic demand that generates their costs. Moreover, amid trends related to multimedia, there are sectors that have accomplished rapid growth thanks to technically innovative advances, coupled with deregulation, and this will also contribute to growth in new industrial sectors.

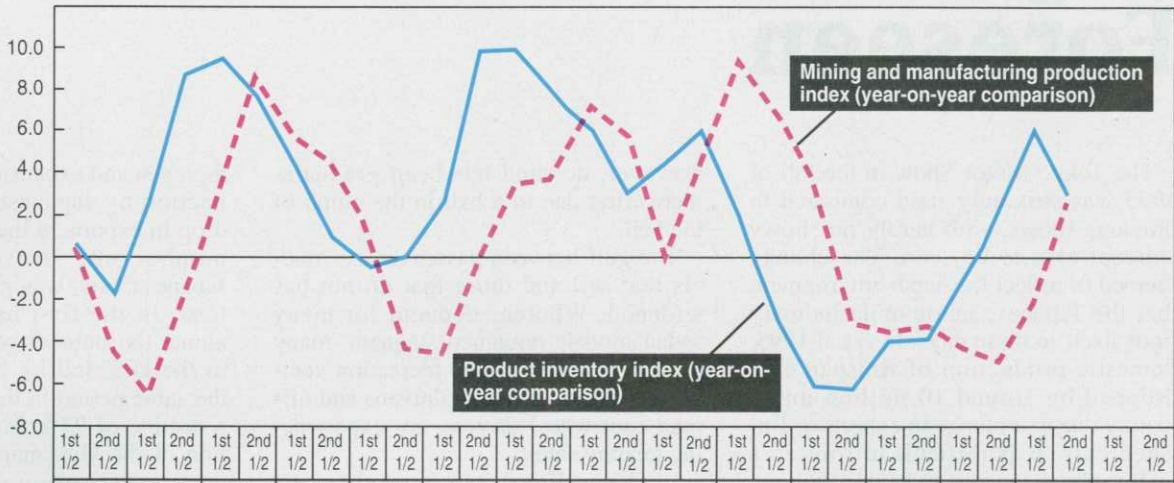
These developments should be expedited and fiscal 1996 will be an important year for Japanese industry to realign itself and move in the direction of structural shifts that will put it on a more favorable course.

(Murata Jun'ichi, senior economist)



### Industrial and Economic Outlook

- Year-on-year increase
- Year-on-year decline of 5% or less
- Year-on-year decline of more than 5%



	FY82	'83	'84	'85	'86	'87	'88	'89	'90	'91	'92	'93	'94	'95	'96
Mining & manufacturing production index															
Rate of operation index															
Large volume electric power															
Machine tool orders															
Construction equipment															
Computer production (by value)															
IC production (by value)															
Number of passenger vehicles sold															
Domestic color TV shipments															
Domestic VTR shipments															
Domestic carbon steel shipments															
Plastic consumption volume															
Domestic cement shipments															
Department store sales amounts															
Supermarket sales amounts															
Volume of travel industry transactions															
Volume of advertising transactions															
New housing starts															
Construction work orders															