Nearing the Peak

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 for dollars shown in parentheses are converted at the rate of ¥130/$.
4. Figures and tables are provided by the IBJ unless specified.

The Japanese economy's current expansionary phase dates back to December 1986, when it began recovering from a slump caused by the yen's sharp appreciation following the September 1985 Plaza Accord. The present boom, however, is likely to peak in 1991, and the economy as a whole may then begin a gentle decline. Some significant changes in Japan's business environment will be the likely trigger of this decline.

In 1985 and 1986, Japanese corporations endeavored to react effectively to the slump brought on by the strong yen. Three-way restructuring through cost reduction, overseas production and diversification was the basic strategy of response. Several fortuitous factors–especially low interest rates, low oil prices and high stock prices (the latter reflecting active fund-raising on the capital markets)–nicely complemented this basic strategy.

As the economy continued to expand strongly, supply could not catch up with demand, and in 1990 labor shortages (particularly of skilled workers) reached serious proportions. Higher wage increases resulted, and inflationary pressures, in turn, intensified. The trucking industry, severely affected by these trends, was plagued by an acute labor shortage in 1990. Distribution costs rose significantly in a wide range of industries such as food processing.

The rise in oil prices triggered by the Gulf crisis has only worsened inflationary pressure.

The impact of higher oil prices on Japanese industry as a whole is probably less than half of what it was at the time of the 1973 oil crisis. This is largely due to the fact that materials-producing industries began switching to non-oil energy around 1980 to reduce their dependence on oil. The impact of rising oil prices on the motor transport industry, however, is likely to be more pronounced, considering that car ownership has nearly trebled since the first oil shock. Amid growing inflationary expectations and the present economic uncertainties, the business environment is beginning to look even more grim. The present triple-blow for businesses in Japan is high interest rates, high oil prices and low stock prices (i.e. sluggish activity on the capital markets).

What trends will major industries follow in the year ahead? That question will be considered below for various key sectors, all based on the assumption that the average CIF price of oil will be $25 a barrel throughout fiscal 1991.

In the assembly and fabrication industries, electronics and electric machinery have already entered a period of temporary stagnation, both in production and earnings, in fiscal 1990. The slowdown in semiconductor production, due to a flattening of prices for memory chips, is one reason for this slowdown. Another is that domestic demand has weakened for general-purpose computers pending shipments of new products in and after fiscal 1991. In fiscal 1991, however, growth rates for both production and earnings are expected to exceed those for fiscal 1990.

One reason for this rosy projection is that the semiconductor industry will begin an upward phase of the so-called silicon cycle, as a result of growing demand for 4M DRAMs. An increase in replacement demand for new-generation general-purpose computers will also likely spur production and earnings growth. Growth in semiconductors and computers is therefore expected to offset a slowdown in the home electronics and heavy electric machinery industries.

In the automotive industry, domestic demand is expected to remain strong, for the time being, supported by the growth of personal income. But the rate of growth of domestic demand is expected to drop to about 2% in fiscal 1991 because of stricter checks to ensure that would-be car buyers have the required parking place as well as higher interest rates on car loans and the "diminishing wealth effect" from the stock market slump. Sales and earnings for fiscal 1990 are likely to increase because of high domestic demand spurred by the shift to higher product lines. In fiscal 1991, it is highly likely that earnings will drop slightly because cost increases–especially higher material prices and wages–will likely cancel out the expansionary effect of shifting to higher product lines.

In general machinery, meanwhile, both earnings and sales are expected to rise in fiscal 1990 thanks largely to sizable order backlogs that will keep production at capacity levels. In fiscal 1991, however, earnings will likely begin to taper, although they will remain at an overall high level. The dip in earnings will result from a cooling of investment enthusiasm among smaller companies due to higher interest rates, and also because profits will likely shrink due to higher costs for materials and outside processing.

The shipbuilding industry is likely to register gains in sales and earnings in both fiscal 1990 and 1991, thanks to increases in prices of new ships and in completion of new ships.

As for the materials sector, the steel industry is expected to suffer profit declines in both fiscal 1990 and the following year. Steel production for fiscal 1990 is expected to reach about 110 million tons, due to increased domestic demand from the construction and other steel-using industries. But cost increases, particularly for raw materials and fuel, interest rate payments and distribution costs, will not be completely absorbed by cost reductions. Production in fiscal 1991 is therefore expected to shrink to about 106 million tons, reflecting a falling off in domestic demand and rising import pressures. Higher costs will also likely continue to impose a heavy burden on steelmakers, resulting in profit decline.

In the cement and nonferrous industries, earnings for fiscal 1990 are expected to rise owing to improvement in the commodity market and smelting margins, as well as growth in domestic demand. In

Corporate Earnings Trends in Major Industries

Industry		Change of current profits over the previous year: FY 1990	Change of current profits over the previous year: FY 1991
Total		➡	⬇ ⬇
Assembly and fabrication	Electronics, electricals	⇨	⇨
	Motor vehicles	⇧	➡
	General machinery	⇧ ⇧	⬇
	Shipbuilding	⇧ ⇧ ⇧	⇧ ⇧ ⇧
Materials	Steel	⬇	⬇ ⬇
	Cement	⇧	⬇ ⬇
	Petrochemicals	⬇ ⬇	⬇ ⬇ ⬇
	Synthetic fibers	⇨	⬇
	Spinning	⬇ ⬇	⬇
	Paper/pulp	⬇ ⬇ ⬇	⬇ ⬇ ⬇
	Nonferrous smelting	⇨	⬇ ⬇
Nonmanufacturing	Department stores	⇧	➡
	Superstores	⇧	➡
	Air transport	⇧ ⇧ ⇧	⬇ ⬇ ⬇
	Private railways	⬇	⇨
	Shipping	⬇ ⬇ ⬇	⬇ ⬇ ⬇
	Construction	⇧ ⇧ ⇧	⇧ ⇧
	Major real estate	⇨	⇨
Energy	Petroleum	⬇ ⬇ ⬇	⬇ ⬇ ⬇
	Electric power	⬇ ⬇ ⬇	⬇ ⬇ ⬇

Notes: 1. Based on a survey of 150 major corporations.
2. Arrows denote increase or decrease of current profits: Three arrows denote increase or decrease rate of 20% or more; two arrows 10% to 19%; one arrow 5% to 9%; and a horizontal arrow zero to 4%.

fiscal 1991, however, earnings are likely to decline because of cost increases, such as higher interest rates.

In the petrochemical industry, earnings are expected to contract in both the current year and fiscal 1991. Sharp price hikes in raw materials, such as naphtha, higher interest rates, increased depreciation costs and further R&D spending, will contribute to this contraction. Earnings are also expected to follow a downward trend in the spinning and pulp-paper industries, due to the present softening of product prices resulting from an oversupply.

All nonmanufacturing industries, in contrast, except private railways and shipping, are expected to post profit gains in fiscal 1990. Private railways are beset by heavy interest payments and labor costs, while shipping companies are plagued by a business slowdown on the North America-Far East liner route, as well as reductions in cargo freight. In fiscal 1991 department stores, superstores and airlines too are very likely to see their earnings shrink as a result of rising raw material and fuel prices, interest rates and distribution costs, all against a backdrop of slowing domestic demand. The construction industry will likely maintain both sales growth and earnings growth, since large backlogs of work will make it possible to pass on increased costs of materials and labor in contract prices.

Finally, the oil and electric power industries, both of which are highly vulnerable to oil price and interest rate hikes, are very likely to suffer large cuts in profits in both the current and subsequent fiscal years.

Altogether, the economic outlook for corporate performance in fiscal 1990 will vary from industry to industry, but overall the prospects are positive, reflecting the continuing vigor of capital investment and consumer spending. Consumer spending in fiscal 1991 is also likely to remain strong, since employment and income will continue to rise as labor shortages become even more acute.

Ultimately, though, a slowdown in capital investment and housing starts will begin to exert a braking effect on the economy. Increases in three major cost factors—oil prices, interest rates and wages—will also inevitably squeeze earnings. Almost all industries are likely to register an earnings decline as a result.

In many industries, however, earnings are not likely to fall as much as they did during the slump of the mid-1980s brought on by the strong yen. Still, the very fact of reduced earnings will surely have a strong psychological impact on business managers who are accustomed to seeing earnings rise continuously. An overall jittery and uncertain business climate, moreover, will likely touch a wide range of industries in the coming year, and growing numbers of businesspeople will begin to sense a general decline in economic activity.

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