

Saturated Market

The past year has marked a change in tempo in the Japanese economy. Domestic industry entered a period of downward adjustment in the summer of 1991 amid growing signs of sluggishness in domestic demand.

Domestic car sales continued to decline on a year-to-year basis, following a downtrend that began in September 1990. In particular, sales of cars with an engine displacement of 2000cc and less, which account for three-quarters of total demand, suffered a serious setback. Orders for construction equipment, machine tools and bearings, a leading indicator of business capital spending, began to drop in the spring of 1991. Domestic steel shipments also started to fall in the spring on a year-to-year basis. Production maintained a high level until the summer but turned downward in August, reflecting a sharp rise in inventories. Construction orders began to decrease in the spring when their double-digit growth came to an end.

High-tech industries also suffered. Demand for computers went downhill in the summer of 1990. Production began to drop in value terms in the April-June quarter, putting an end to the double-digit expansion that had continued for more than a decade since 1978.

The weakening of domestic demand generally pushed up inventory levels and reduced incentives for business investment in new plant and equipment. As a result, productive activity entered a downward adjustment phase in the second half of fiscal 1991 as a growing number of producers moved toward cutting production.

The downtrend in industrial activity partly reflects weaker business confidence due to the collapse of the so-called "bubble economy," the wild asset-price inflation that created an unprecedented boom in the stock and property markets in the late 1980s. A more fundamental reason, however, is that domestic industry entered a period of stock correction

as a result of the "saturation" of the real economy.

Domestic demand for motor vehicles increased at an annual average rate of 2.2% in the five years from fiscal 1980 to 1985. By contrast, the average rate of growth in the next five years (fiscal 1985 to 1990) reached as high as 7%, driving producers to run their factories at full capacity. By the same token, housing starts surged ahead at about 1.7 million units a year in the four years from fiscal 1987, with the result that housing construction reached close to saturation point. (The "normal" level of housing starts is thought to be 1.30 to 1.39 million units.)

Thus stocks of certain durable goods remained at unusually high levels for a number of years. Demand for these goods increased so rapidly that even part of future demand was pre-empted. In 1991, however, demand fell in reaction as the market became saturated. This is likely to continue into 1992.

Capital spending had also been stepped up against a backdrop of surging demand. In the three years from fiscal 1988 to 1990 it increased at double-digit rates, exceeding 20% of GNP. Of course, capital spending was also spurred by low interest rates and high stock prices, which made it possible to raise money at extremely low cost on capital markets. Domestic demand began to recede, and the supply-demand balance collapsed, with the result that involuntary inventories piled up and market conditions deteriorated markedly. That is what happened around the summer of 1991.

With production curtailments gaining momentum, a sharp slowdown in capital spending seems certain to be recorded in fiscal 1991. Current projections are that it will rise only about 5% from fiscal 1990. The rate of growth is likely to dip further in fiscal 1992. Major contributors to the investment slowdown are the automobile and semiconductor industries, which have provided the main thrust of capital

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- 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.

spending over the past several years. By contrast, investment in materials-producing industries, such as steel, nonferrous metals and chemicals, is expected to maintain a relatively high level in fiscal 1991, thanks largely to the "residual effect" of projects now in progress. In fiscal 1992, however, considerable restraint is likely to be imposed on capital outlays, reflecting a further deterioration in the supply-demand balance.

Looking ahead to fiscal 1992, demand is not likely to recover in certain consumer-related industries, notably autos and audio-visual equipment like VCRs. However, consumer spending as a whole is likely to maintain a firm trend, thanks to strong demand in the following areas: fast food and precooked food, and take-out lunches (reflecting the growing number of working women); air conditioners, heating carpets and portable phones.

Housing starts are projected to stay around 1.3 million units, as in fiscal 1991. In addition, demand is forecast to remain sluggish in such areas as trucks, machine tools and construction equipment owing to a loss of business enthusiasm for plant and equipment investment.

Corporate earnings declined as early as fiscal 1990, due mainly to increases in fixed costs, such as personnel, distribution and depreciation costs. But sales expanded as production and shipments increased, and unit prices for value-added products soared. In the second half of fiscal 1991 output is expected to level off or drop as a result of production adjustments. Moreover, as sales level off, the fixed cost burden is bound to rise, thus cutting further into profits.

Finally, let us look back on how major sectors have performed so far in fiscal 1991—and take a brief look into how they will fare in fiscal 1992.

In the assembly and fabrication industries, domestic production of electronics and electric machinery has leveled off for two major reasons—shipments of general-purpose computers remained sluggish,

and production of semiconductors stagnated due to falling prices for memory chips. In fiscal 1992, domestic demand is expected to remain weak and production to continue its downward trend. However, export production of computers and semiconductors for the U.S. is likely to recover.

Domestic demand for cars is expected to drop in fiscal 1991 for the first time in 11 years. In fiscal 1992 demand is expected to remain almost unchanged from fiscal 1991, largely because of a scheduled cut in the auto consumption tax. Negative growth in production is a likely prospect, as the outlook is for continued declines in export sales.

Production of general machinery is expected to decrease in fiscal 1992, reflecting a deceleration in domestic demand due to capital spending cutbacks in the user industries. Exports are likely to lose upward momentum.

Shipbuilding orders are expected to level off, due to higher ship prices and a cyclical slump in replacement demand from Japanese shipowners. However, the uptrend in sales and profits is likely to continue because launchings are expected to increase, thanks to a high level of back orders.

As for materials-producing industries, production of steel, petrochemicals and synthetic fibers is expected to remain sluggish, as demand from the construction and auto industries continues to decline. Producers of these basic materials are likely to cut production further in order to cope with bulging inventories.

Demand for pulp and paper is expected to remain in the doldrums, particularly for high-grade paper for books and other printed matter, and for various forms used at financial institutions. As a result, market conditions are expected to deteriorate further. Demand for cement, however, should maintain a high level because public-sector civil engineering projects are expected to make up for less demand in private-sector construction.

Production of nonferrous metals should remain steady, partly because of expected strong demand for electric cables, reflecting stepped-up equipment investment by power companies. Produc-

Trends in Income Performance by Major Industries

Industry	Change of recurring profits over the previous year	
	FY 1991	FY 1992 (forecast)
Total	↓↓	↓
Electronics/electricals	↓↓↓	⇒
Automobiles	↓↓	↓
General machinery	↓↓	↓↓↓
Shipbuilding	↑↑↑	↑
Iron and steel	↓↓	↓↓↓
Cement	↓	↓↓↓
Petrochemicals	↓↓↓	↓↓↓
Synthetic fibers	↓↓	↓↓↓
Spinning	↓↓↓	↓↓↓
Pulp and paper	↓↓↓	↓↓↓
Nonferrous metals	⇒	⇒
Department stores	↓	⇒
Superstores	⇒	⇒
Air transport	↑↑↑	↓
Private railways	↓	↑↑↑
Shipping	↓↓↓	↓↓
Construction	↑	⇒
Major real estate	⇒	↓
Petroleum	↑	↓↓
Electric power	↑↑	↓↓

Note: Positive/negative growth indicators

↑↑↑ (↓↓↓) Gain (decline) of 20% or more ↓ (↑) Gain (decline) of 5% to 10%
 ↑↑ (↓↓) Gain (decline) of 10% to 20% ⇒ (⇒) Gain (decline) of 0% to 5%

tion of aluminum is also expected to remain strong, centering on demand for beverage containers. However, profits in the materials industries as a whole are likely to decline in fiscal 1991-1992, owing to increased fixed costs and deteriorating marketing conditions.

In the nonmanufacturing industries, aviation is headed for a severe profit setback. Factors behind this are a slowdown in the number of business travelers on trunk routes, a leveling off in the number of overseas tourists, and intensified competition. In shipping, the deficit in liner services is expected to be reduced, while tanker services should remain in the black. In tramper services, however, demand is likely to drop, and a decrease in car shipments in particular is likely to squeeze profits in this sector.

The real estate industry is expected to remain below break-even point. Construction costs are likely to keep on rising while the market for condominiums is expected to remain depressed. Con-

struction starts are expected to drop as a result of a fall in housing starts and a further slowdown in private-sector capital spending.

Department store sales are also expected to weaken with the plunge in sales of high-priced items such as art objects. On the other hand, superstores are expected to see more rapid sales growth than department stores, reflecting the continued firmness in demand for processed food and daily essentials.

To sum up, Japanese industrial activity is expected to enter a more pronounced phase of downward adjustment from fiscal 1991 to fiscal 1992, reflecting a weakening of business confidence. However, inventory correction should have made good headway by the second half of fiscal 1992. It is therefore not expected that business conditions will deteriorate at an accelerated pace, or that any sense of gloom is likely to pervade industry. ■

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