Fewer Housing Starts in Reaction to Rise in Consumption Tax

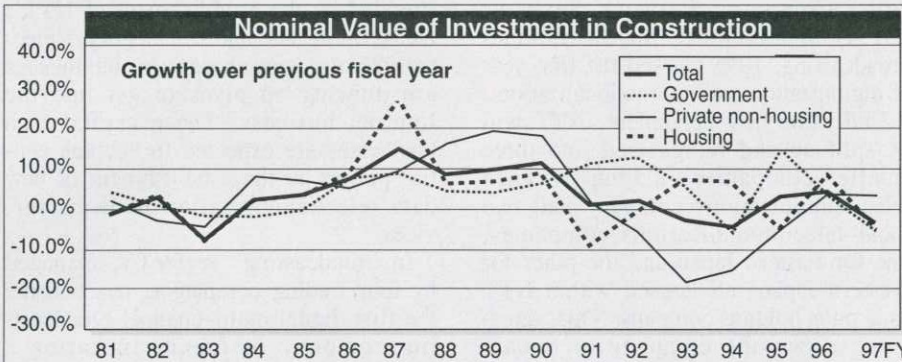
Recent trends

Housing construction drives the construction market

In fiscal 1996, investment in construction are expected to have gained 4.9% over the previous year, hitting ¥84.3 trillion (nominal value).

Boosted by the hefty fiscal 1995 revised budget, publicly funded construction grew sharply in the first half of the fiscal year; growth was slower, however, in the second half. In the private sector, investment in housing construction jumped by 8.9% due to low interest rates, falling land prices, and a surge in demand just before the implementation of the new consumption tax hike. Housing starts in 1996 were expected to have topped 1.58 million.

Construction of shops and factories is spearheading the recovery of the private non-housing sector. An expected 4.3% increase in office building construction will put an end to that sector's downturn and mark its first growth in five years.



Note: Figures for fiscal 1996 and 1997 are projections by Industrial Bank of Japan
Source: Ministry of Construction

Private sector growth supported by new contracts

New contracts for 50 major construction companies in the 1996 fiscal year were projected at ¥21 trillion, a 6.4% increase over the previous fiscal year and the first large gain in several years. Contracts from government agencies were expected to have dipped by 8.1% to ¥6.5 trillion, after having grown sharply with the hefty revised fiscal 1995 budget. Contracts in privately funded construction were expected to have come to ¥12.8 trillion, a 14.5% gain over the previous fiscal year that has been fueled by favorable conditions for housing starts and the recovery of the non-housing sector. The prospect for the latter half of fiscal 1996 looms tepid as the temporary surge of demand is at its ebb, while profitability of the housing sector is basically low.

Times still tight for major firms

A look at the earnings and expenditures of 77 major general construction companies listed on the stock exchange reveals that sales revenue in fiscal 1995 leveled off after three terms, but current profits shrank four terms in a row. While in fiscal 1994 the manufacturing industry saw its profits increase for the first time in five terms, the construction industry is still in recession, largely due to the time lag between contracting for a project and the summing up of sales.

Overall profit on sales has fallen dramatically. Revenue from contracts made before the recession has been collected, and we are currently seeing the adverse impact of lower profit contracts from the period when the market sagged.

Future outlook

The shrinking construction market

Investment in construction for fiscal 1997 (nominal value) is expected to shrink by 2.8% from the previous fiscal year, to ¥82 trillion. The public sector has overextended itself in the face of continually revised budgets, and reductions in government spending are inevitable.

Housing starts are predicted to stay at a high of 1.48 million, but now that the pre-consumption tax rise rush on house building has come to an end, there will be fewer housing starts after fiscal 1996 as a reaction to the shrinking surge in demand.

Modest continued growth is expected in the private non-housing sector. But market conditions will not be robust enough to create a very strong recovery, and the market will reach only 70% of its peak value.

Modest growth in new contracts

Investment in construction will be bearish in fiscal 1997; the total number of contracts at the top 50 construction companies is expected to rise only 0.7% over the previous fiscal year. Government contracts have basically fallen by 2.6%. The shrinking market for housing construction will dampen overall growth in private sector contracts, slowing growth down to a modest rate of 1.4% over the previous year.

Company earnings and expenditure balance still lagging

Company earnings and expenditures in fiscal 1997 will rise as companies receive more contracts in the private non-housing sector. But absolute numbers of contracts will still be substantially below peak levels, and fierce competition will keep gross profit down.

The balance sheets of the 77 listed companies reveal that revaluation of their inflated assets is not proceeding with falling revenues. An inflated book value in fixed assets such as land or buildings is left uncorrected and balance sheets show large amounts in receivables for finished construction and expenditures on unfinished construction—demand for construction working capital. Concerned that their assets are being undermined by hidden losses in fixed assets and irrecoverable bad debts, and concerned also with the substantial risk of fluctuations in interest rates, companies are required to reduce the amount of interest-laden loans they take out.

(Kunieda Satoru, economist)