

Slowed Profits Places Construction Industry on Brink of Recession



Restoration work in Kobe following last year's disaster.

Nominal investment in construction in FY 1995 totaled ¥82.4 trillion (according to the Industrial Bank of Japan, Ltd. (IBJ)'s Industrial Research Department forecasts), or a 1.1% increase compared to fiscal 1994, indicating minimal growth in the construction market.

Following the Great Hanshin-Awaji Earthquake and the economic stimulus package's supplementary budget, the public works sector, which appeared out of breath at the start of the fiscal year, finished the year with a 7.2% year-on-year increase of ¥39.5 trillion and served to prop up the market for the year as a whole.

Meanwhile, in the private sector, which had sustained solid growth thanks to low interest rates, prices and property prices, the housing sector appeared set for an adjustment. The private non-housing sector felt the repercussions from the sluggish office space market and declining construction prices. Although the margin of decline had certainly diminished, a continuing slump appeared inevitable, with the overall private sector market limited to ¥42.9 trillion, a 3.9% decline compared to the previous fiscal year.

However, it is anticipated that the construction market can expect a healthy ¥84.7 trillion in investment in FY 1996,

or 2.8% more growth than in FY 1995.

Along with anticipated base demand of around 1.43 million new housing starts, the residential sector should see resurgent demand fostered by expectations that the slide in interest rates will halt, as well as a spurt of demand in anticipation of the consumption tax increase.

Against a backdrop of growing sentiment in favor of additional housing stocks and enhancements to living environments, an increasing need for new or renovated housing should also serve as a factor in underpinning future housing investment.

However, there is anticipation that the public works sector, which propped up the construction market in 1995, can look forward to a high level of growth due to an infusion of investment based on the large supplementary budget of fiscal 1995. Nonetheless, with concern over a slowdown beginning in the latter half of the year, brought on by a setback compared to the latter half of FY 1995 and limitations on public finances, market trends will bear watching.

The non-housing sector is also expected to approach a fundamental turning point, gradually raising standard levels, but in absolute terms this will not exceed the levels of the latter 1980s and will be insufficient to give the market environment a substantially positive boost.

The outlook for corporate earnings is that an overall slump is inevitable. As far as the earnings situation for industry leaders is concerned, it already appears unavoidable that the 77 first-tier general contractors' financial results (based on IBJ Datafile) will reflect the third consecutive full-term decline in profits since

fiscal 1992. The manufacturing industry, which had four years running of declining profits until FY 1993, reverted to earnings and profit growth in fiscal 1994, but it could indeed be said that the construction industry, which faces a time lag before construction orders can be counted toward profits, now faces the onset of a recession.

In fiscal 1996 it is thought that orders, which have been flat, will gradually begin to rebound in terms of value, but will be no more than 75% of the top 50 firms' high point in absolute terms and, particularly in the private sector, a mainstay for profits, will decline sharply to a bit less than 60% of the peak period. There are no expectations of a rapid future rebound in orders, either.

There is additional concern over a drop in the ratio of gross profit to sales (gross profit ratio). Orders booked as profits during the boom cycle have been closed out and it is anticipated that the effects of orders that cut into profitability following the deteriorating market climate will now finally begin to appear in balance sheets. That the top general contractors, a high ratio of whose business comes from the private non-residential sector, cannot look forward to a rapid recovery in profits indicates in itself that the deteriorating earnings climate will have a serious impact on their balance sheets. It is also possible that the rapid implementation of various systemic reforms related to public works contracting procedures, especially the introduction of an open competitive bid formula, will increase the severity of the competition in the market in future.

Along with the prompt disposition of idle assets that were frozen as the "bubble" was in the process of collapse, drastic operational and structural reform is required.

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