

Asian Crisis Expected to Cut Profits Sharply

Recent trends

Stagnating domestic demand

Domestic demand for petrochemical products was strong during the first half of fiscal 1997, on account of the strong performance of the auto and household appliance industries. As autumn began, however, the effects of the economic down-turn began to be felt, and demand sank. Year-on-year growth for the year overall is expected at 0.5% for 5.91 million tons (based on demand for ethylene).

Let's look at trends in synthetic resins, which account for around 60% of domestic petrochemical demand. Looking at the year-on-year growth rate in total shipments of five major all-purpose resins, growth was maintained in the first quarter following a strong fiscal 1996 figure. Growth subsequently fell, however, due to the effects of the economic down-turn. In the third and fourth quarters, the year-on-year change in shipments of all five resins was on the negative side. Looking at fiscal 1997 overall, it appears that shipments of each resin (excluding PS (polystyrene) shipments, which were depressed in fiscal 1996) will end up below 1996 levels.

Specifically, the drop in PVC (polyvinyl chloride) shipments was conspicuous, driven by a drop in housing investments and reduced public sector investments. Even PP (polypropylene), where use in industrial parts has kept shipments growing in recent years, couldn't hold its own in the second half of the year in the wake of production cuts in the auto industry and elsewhere. Shipments of LDPE (low-density polyethylene) and HDPE (high-density polyethylene), the main materials used for plastic films, also slowed, reflecting the drop in personal consumption. PS, which experienced negative growth in the previous year, is not expected to recover much in fiscal 1997, but to remain at this low level.

Domestic shipments of raw synthetic fiber are forecast to exceed fiscal 1996

figures and synthetic rubber shipments are forecast to show a slight year-on-year increase.

Falling exports due to the effects of Asian economic upheaval

Petrochemical exports are supported by demand from Asia, which accounts for over 80% of total export demand. Since 1994, the year-on-year rate of expansion of petrochemical exports has been in double digits, but that completely changed in late fiscal 1997.

Although there were slight variations among different resins, in general, exports to China and Hong Kong were strong during 1997. Despite a drop in volume of LDPE and PS, exports of PVC, HDPE and PP grew healthily behind a cheap yen. However, the supply and demand gap shrunk as petrochemical plants came on line in Asia and the Asian economic crisis bore down. Starting around December, local demand began to weaken. From January, exports fell dramatically for all save a few types of resin. For 1997 overall, the year-on-year comparison is expected to show a 2.54% decrease to a total of 1.76 million tons. Imports are expected to fall slightly from the previous year.

Firm ethylene production

Ethylene production was strong through December, due to favorable conditions in the first half of the year and strong exports. Despite depressed domestic demand and low exports during January and February, high plant operating rates continued due to moves by ethylene centers to build up inventory prior to shutting down for regular maintenance. (As of March 1998, ethylene centers were being operated by nine companies and 11 "keiretsu" affiliated companies.) Total 1997 production is expected to show a 1% increase over the previous year to hit the highest-ever production volume of 7.37 million tons.

Corporate earnings

Petrochemical makers raised resin prices between October 1996 and July

1997 due to rising raw naphtha prices, but because of price hikes following increases in raw material prices, makers ended up with increased costs of around ¥4 billion.

Meanwhile, the drop in sales volume made a ¥12 billion decrease in profits inevitable. However, companies shaved costs by around ¥25.7 billion through financial accounts adjustments accompanying consolidating loans, low interest rates and rationalization. Consequently, the five main companies anticipate a total increase in earnings of around ¥9.7 billion. Actual ordinary income (ordinary profit excluding earnings from sales of marketable securities regarded as non-operating income) is expected to reach around ¥98.7 billion.

By field, petrochemicals saw a drop in profits, whereas fine chemicals, with a high proportion of exports such as agricultural chemicals, saw profits from the cheap yen. New fields, such as electronic information, are also expected to record higher profits.

Future outlook

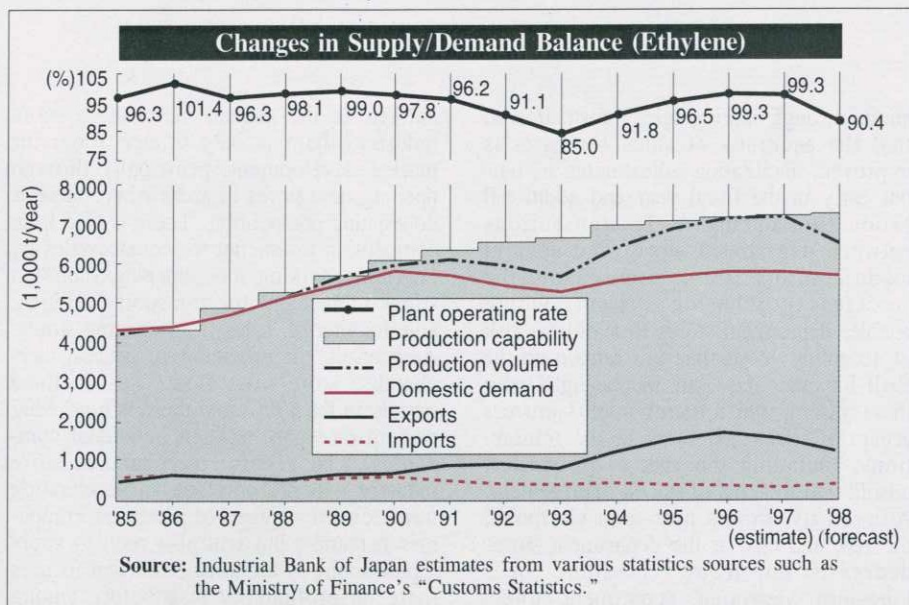
Domestic demand to remain low

The economic recession in Japan, which began in the latter half of fiscal 1997, is expected to continue into fiscal 1998. The real GDP growth rate is forecast at -0.5%, the first negative growth rate in 24 years.

A decline in personal consumption and a reduction in housing and public investments is expected in light of the recession. There are no grounds for anticipating an increase in production of manufactured products such as automobiles or household electrical appliances either. Consequently, overall growth in domestic demand for petrochemical products is predicted at -1.3%, the first negative growth rate in five years.

Reduction of the import/export imbalance

While Asian demand for petrochemical exports in fiscal 1998 is expected to decline precipitously under the impact



of the Asian economic crisis, Japan can expect to feel export pressure from countries like South Korea, Thailand and Indonesia, which need to acquire foreign currency. In Asia, China is the only country expected to be in a position to import petrochemical products, thereby setting the stage for fierce competition. A major decline in the global market for petrochemicals is anticipated. Under these conditions, Japanese exports will drop dramatically, with predictions of a year-on-year change of -17.3%, pushing total exports down to 1.4 million tons.

Meanwhile, Asian countries that have become competitive through currency devaluation are expected to launch an export offensive directed toward Japan. Consequently, imports are expected to grow by 22.3% over the previous year to a total of 540,000 tons.

As a result, the fiscal 1998 gap between exports and imports is expected to shrink to 870,000 tons, 390,000 tons less than the previous year.

Falling ethylene production to greatly reduce operating rates

With stagnant domestic demand and forecasts of dramatic drops in exports, ethylene production is expected to dip far below the 7 million-ton level to 6.7 million tons (-8.5% compared to the previous year). Consequently, plant

operating rates are expected to drop precipitously to 90.4%.

Fiscal 1998 settlement of accounts in petrochemical sector expected to show huge drop in earnings

Looking at the environment surrounding fiscal 1998 corporate earnings, production and sales volume both declined. On the price side, downward pressure on prices is expected due to international market conditions upset by domestic prices and the fall in raw naphtha prices. In addition, the decline in the international market will greatly worsen the profitability of exports, thereby heightening already dire conditions to a new level.

Meanwhile, an earnings increase in the non-petrochemical sector—which previously contributed to increasing profits—is difficult to envisage in the midst of a declining domestic economic climate.

As a result, although petrochemical makers will continue to make efforts to cut costs, it is thought that a large drop in profits will be unavoidable due to the rapidly changing environment surrounding the business conditions discussed above.

Petrochemical industry works to further strengthen its internal structure

Japan's petrochemical industry currently has an unstable earnings structure

caused by the effects of the increased fixed costs burden dating back to large-scale investments made during the bubble economy. Consequently, the declining operating rate is exerting a strong downward force on earnings.

In fiscal 1998, exports to Asia, which supported the expanding ethylene production of the past several years, will be depressed due to the currency crisis. Exports will fall dramatically. Domestic demand is also expected to remain stagnant. Consequently, the operating rate is forecast to fall to around the 90% level and little room for profit-making by the petrochemical corporations is anticipated.

In this atmosphere, strengthening the earnings structure is urgent. One measure put forward is to eliminate excessive competition. Although the petrochemical industry has been pursuing various forms of industry reorganization and consolidation since fiscal 1994, excessive competition has yet to be eliminated. Although improved business practices in the polyolefin area, such as minimizing grades and abolishing of the deferred price-setting system, are being advanced and the effects of restructuring are gradually being felt, deeply rooted problems, such as the unresolved debt structure within the industry even after the establishment of business tie-ups in the PVC area, still remain.

It is hard to imagine that the economic upheaval caused by the Asian currency crisis will be straightened out in the near future; the difficult business environment in which the petrochemical industry finds itself now is expected to continue. At the moment, moves in the direction of planning production to fit demand in order to maintain domestic market conditions and toward realizing decreased production are being seen in the form of a shift from an emphasis on maintaining volume to an emphasis on profit-making. However, in order to pursue further improvement of the industrial structure, further promotion of alliances and the elimination of excess plants will become necessary. ■

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