Industrial Survey 1998

Compiled by the Industrial Research Department of the Industrial Bank of Japan, Ltd.

Notes: 1. Year are calendar years unless specified.
2. The fiscal year is from April to March.
3. Figures and tables provided by the IBJ unless otherwise specified.

Industrial economy lingers in stagnation

The Japanese industrial economy in fiscal 1998 will be stagnant as in the previous fiscal year. Economic recovery is not foreseen because, firstly, domestic demand is in a serious slump and, secondly, exports which supported the industrial economy in fiscal 1997 will run out of steam. Even though the large-scale economic stimulus package announced by the government may produce some effect, the industrial economy will show only slight recovery at best.

For some time after hitting bottom in October 1993, the industrial economy traced a moderate recovery track. In early fiscal 1997, however, it was caught in stagnation again and showed stronger signs of recession in the second half of fiscal 1997. The mining and manufacturing production index traced a zigzag course, and in November 1997, the seasonally adjusted mining and manufacturing production index stood at 97.8, declining below 100 for the first time since December 1996. The Diffusion Index revealed in the *tankan* (quarterly short-term economic survey) report by the Bank of Japan, based on the June 1997 survey, took a downward direction and has been showing a dismal trend since then.

Personal consumption expenditures, too, remained stagnant, dashing expectations that the adverse reaction to the consumption tax increase in April 1997 would cease during the first half of fiscal 1997. The stagnation continued under the synergistic effect of the abolition of the special income tax cut, the unseasonable weather during the summer, an increase in patients' share of the cost of medical service due to a revision in the medical insurance scheme effective from September, and the instability of the nation's financial system. Consumer spending cannot provide a stimulus which would trigger recovery, so it will continue to remain stagnant in fiscal 1998.

Exports were firm in fiscal 1997. Assembling and processing industries such as motor vehicles, electronics and electrical machinery fared well on the export front mainly because they were helped by the strong performance of the United States economy and the yen's weakness at around ¥120–¥130 to the dollar. Basic materials industries enjoyed a growth in exports, with shipments to Asia leading the way, the exports supporting their production activities in Japan. However, export growth has been slowing down since the second half of fiscal 1997. In particular, the economic crisis in Southeast Asia has had a strong dampening effect since the beginning of January 1998. A slowdown in exports, therefore, seems unavoidable.

Business investment in plant and equipment will not grow, because the Asian economic crisis will produce a full-scale impact in addition to the recession in the domestic economy. It deserves special mention that the destabilization of the nation's financial system since the second half of fiscal 1997 is making it difficult for companies to procure funds. A survey of business investment in plant and equipment conducted by the Industrial Bank of Japan in February 1998 has revealed that capital investment in fiscal 1997 showed a 2.9% gain over the preceding fiscal year, an increase for the third straight year, but would decline 1.6% in fiscal 1998 from the previous fiscal year. By purpose, capital investment at present is limited to strategic purposes, such as information and telecommunications, environment conservation and the enhancement of added values as well as the maintenance or renewal of equipment. Undeniably, capital investment lacks power as a booster for the industrial economy.

The stagnation in consumer spending is showing its effect most markedly on retail trade. For example, sales of both department stores and general merchandise stores, limited to sales at already-existing stores, will decrease in fiscal 1998 even compared with fiscal 1997, when the effect of the higher consumption tax emerged. Consumer spending will take considerable time to recover because consumption expenditures on daily necessities do not grow as a result of the maturation of personal consumption and in addition, selective purchases of such goods as brand-name apparel, personal computers and telecommunications apparatus also lack strength.

Investment in housing, too, is sluggish. The number of housing starts, which reached 1.63 million units in fiscal 1996, thanks to accelerated purchases before the consumption tax increase and the general belief that the housing loan interest rate had hit bottom, declined to an estimated 1.33 million units in fiscal 1997 and is likely to sag further to 1.29 million in fiscal 1998. Investment in construction in fiscal 1997, including housing, seems to have declined 7% from the preceding fiscal year because housing investment was stagnant and public investment was strictly curbed in line with the fiscal reconstruction policy. At present, a further decline of ¥4 trillion in construction investment is foreseen for fiscal 1998. Whether the government will make additional appropriations for public investment to stimulate the economy merits watching.

In the manufacturing sector, the assembling and processing industries are faring relatively well, but basic materials industries are depressed.

Automobile production in fiscal 1998 will show a fractional drop of 2%.

Domestic automobile sales showed a 14% decline to 6.28 million units in fiscal 1997 from the preceding fiscal year's level, partly in reaction to the accelerated purchases before the consumption tax increase in April 1997. Sales in fiscal 1998 will total 6.4 million units, showing only a 2% gain even compared with the low fiscal 1997 level, even though fiscal 1998 ought to be the year for replacement of cars purchased during the bubble period. Owning the same vehicles for a longer number of years has become an established trend among motorists as the consumer mood has deteriorated. Exports will take a downturn because, for one thing, demand in Asia is stagnant.

Production of electronics and electrical machinery is likely to trace a flattened-out course in fiscal 1998 despite expected moderate gains in exports to some countries including the United States, because domestic demand for household electrical appliances, computers and telecommunications apparatus will decline. The number of personal computers shipped to the domestic market, which declined 8% in fiscal 1997 from the preceding fiscal year, will show a fractional gain of 2% to 6.74 million units in fiscal 1998 over the preceding fiscal year.

Basic materials industries, already affected by the stagnation in domestic demand, will be hit hard by the decline in demand from Southeast Asia. Crude steel production totaled 100 million tons in fiscal 1997, showing a gain of 2% over the preceding fiscal year, as an increase in exports offset the decline in domestic demand, but a 6% decline to 97 million tons in fiscal 1998 from the preceding fiscal year is foreseen. As regards the outlook for the petrochemical industry, ethylene production, which rose to a record level in fiscal 1997 in a fractional gain over the preceding fiscal year, will decline 9% in fiscal 1998. Basic materials industries occupy a sector where speedy creation of demand through economic stimulation is greatly needed.

Telecommunications, on the other hand, will continue to show strong growth. The increase in the number of subscribers to mobile communications (cellular telephones and PHS (Personal Handyphone System)) is tending lower as a result of the rise in the market penetration rate. Nevertheless, a 41% increase was seen in fiscal 1997 over the preceding fiscal year, and a 13% gain is foreseen for fiscal 1998. The number of subscribers is expected to reach 43 million at the end of fiscal 1998. The popularity of cellular telephones is evident when compared with the number of subscribers to stationary telephones in Japan, which is approximately 60 million.

Corporate profits to decline

On the assumption that the average yen-dollar rate in fiscal 1998 will be around ¥130 to the dollar, there is a strong probability that corporate profits in fiscal 1998 will decline as a whole, although some improvement is foreseen in the assembling and processing industries.

By industry, profits of the electronics and electrical machinery industries will show double-digit gains mainly because the semiconductor industry, which suffered a heavy setback in fiscal 1997, will report smaller losses. Automakers' profits will show a fractional gain as a result of the weak yen.

Basic materials industries will suffer a major decline in profits despite the effect of restructuring, because domestic demand is low and the supply-demand situation in Asia, the major export market, has deteriorated. The paper and pulp industry's profits will plummet as the paper and pulp market is sagging under the startup of large production facilities, although production is firm.

In the nonmanufacturing sector, department stores and general merchandise stores, housing, construction, real estate and civil air transport will suffer profit declines across the board. The telecommunications industry, too, will report decreased profits despite market expansion, because all common carriers are engaged in a cutthroat price war.

As regards the prospects for energy industries, the harsh environment for the oil industry's profits will last because the end-user market is depressed. The electric power industry's profits will decline despite a possible rise in amount of sales, because power rates were lowered in February 1998.

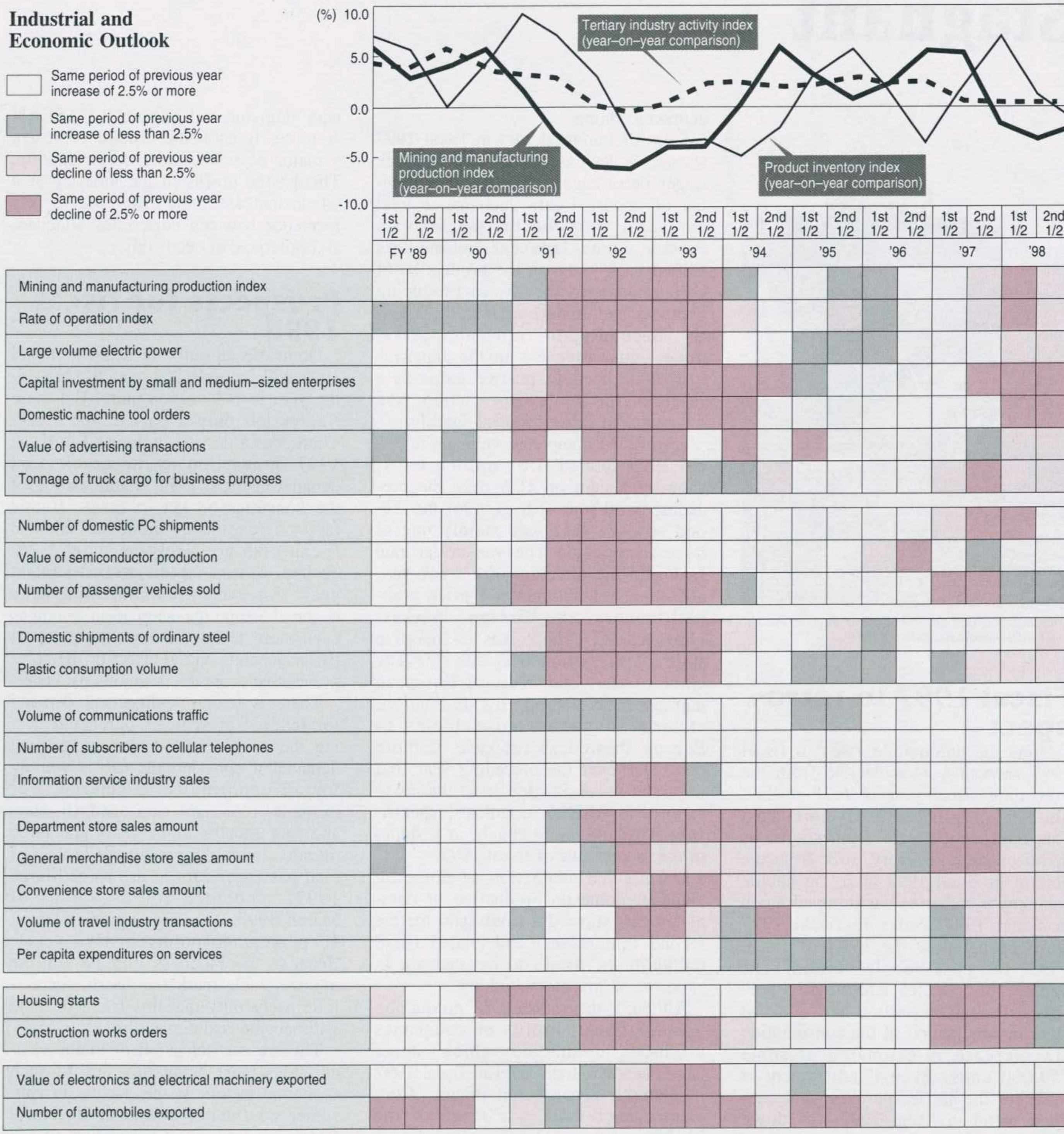
Establishment of solid business foundations desirable

The Japanese economy, now stagnant for several years, is showing a clear pattern of the zero-sum game, where there can be no market growth and there are victors and losers in the scramble for a market of limited size. Harsh competition is arising in all industries with the progress in globalization and the spread of a competitive environment even involving growth industries. The survival of the fittest is the name of the game. This is an age when even such domestic demand-oriented industries as energy, land transportation and construction must be conscious of international competition as well as competition within the same industry. In this age, when customer industries freely shift their production bases across national borders in search of the ideal location, even the competitiveness of domestic demand-oriented industries becomes an object of international comparison in calculating the cost of global operations.

This trend of survival of the fittest, though nothing new, is accelerating now as a result of the further spread of globalization, the acceleration of innovations and the expansion of a competitive market through structural reform of the Japanese economy. In order to survive the ensuing harsh competition, companies must have a powerful financial constitution and managerial ability that can formulate a clear-cut operational strategy and select the appropriate scope of operations. Debate at the industry level is certainly important, but first and foremost, individual companies must bolster their competitiveness to survive the harsh competition. If each company displays strength in the area where it excels, the make-up of Japan's industrial structure will be transformed.

(Nakayama Hirobumi, senior economist)

Industrial and Economic Outlook



Note 1: FY1997 estimate
Note 2: Year-on-year communications volumes
Note 3: Department store and general merchandise store sales based on existing outlets. Convenience store sales are the average annual sales per store
Note 4: Per capita expenditures on services are expenditures on service per member of household revealed in the Family Income and Expenditure Survey.

Domestic Market Remains Stagnant

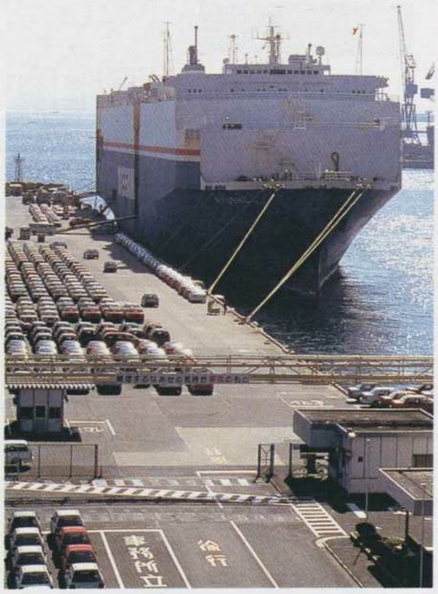


Photo: Nissan Motor Co. Ltd.

Forecasting export decline : Factors such as Asian crisis influenced exports in FY1998

Fiscal 1997 in retrospect

Domestic automobile sales in fiscal 1997 showed a 14% decline from the preceding fiscal year to 6.28 million units, mainly because of diminished consumer confidence. Domestic sales had been on a recovery track from the bottom in fiscal 1993 after the bubble economy's collapse, but dropped again in fiscal 1997. Sales in fiscal 1997 were even below the level of fiscal 1993, the post-bubble bottom. The number of vehicles additionally purchased during the second half of fiscal 1996 in anticipation of the consumption tax increase is estimated at some 250,000 units. Even if adjustment is made for the hurried purchases, domestic demand in fiscal 1997 was down 10%-plus from the preceding fiscal year. Car sales were directly hit as a result of the thrifty mood that prevailed among consumers in reaction to the economic slump.

Sales of imported cars in fiscal 1997 showed a decrease of 27%. The much larger percentage decrease in the number of imported cars than that in total car sales was due to two factors. Firstly, some Japanese automakers shifted back to Japan the production of certain vehicles they were producing overseas and importing into the country. Secondly, foreign automakers' price competitiveness in the Japanese market declined in relative terms as a result of the yen's depreciation, and their sales in Japan dropped sharply.

Exports of completed vehicles in fiscal 1997 totaled 4.67 million units, showing a gain of 21% over the preceding fiscal year. The gain for the second straight year was mainly due to three factors: (1) The yen-dollar rate swung in the direction of a weak yen, and Japanese automakers' price competitiveness in foreign markets improved. (2) There was no massive shift of production overseas. (3) The United States and Western European markets were strong. By destination, exports of completed vehicles to Europe showed an increase of more than 20% over the preceding year, but exports to Asia declined because exports to ASEAN countries, specifically Thailand, were caught in a slump in the second half of fiscal 1997.

Despite the stagnation of domestic demand, domestic production of completed cars showed a small gain for the second straight year and totaled 10.78 million units, thanks to the increase in exports and inventory buildup.

Although the increase in production was fractional, profits of companies producing completed vehicles must have been at a high level in fiscal 1997 in general, because net income from exports increased as a result of the yen's weakness. On the other hand, truck builders' profits must have declined because the price war escalated at a time when the domestic market was stagnant and exports to ASEAN countries in economic trouble represent a major portion of total truck exports. Though the profits of the industry as a whole increased, the difference in performance between companies widened, and polarization occurred.

Prospects for fiscal 1998

Domestic automobile sales in fiscal 1998 will increase 2% over the preceding year to 6.4 million units. But these figures tell only a part of the story. There was a decline in demand in fiscal 1997 in reaction to the accelerated demand in fiscal 1996 in anticipation of the consumption tax increase. If this factor is excluded, domestic sales in fiscal 1998 are likely to show a 2% decline, a drop for the second straight year. An even greater decline may occur if economic stagnation becomes even more serious, though the prospect partly depends on the effect of the comprehensive economic stimulus package.

There is strong replacement demand for renewal of vehicles purchased during the bubble period. Latent renewal demand of considerable size is waiting for an opportunity to emerge. For example, passenger cars aged 10 years and four months to 11 years and three months, which represented 24.1% of total passenger cars in use as of March 1992, accounted for 34.9% as of March 1997, showing a gain of about 10 percentage points in five years. Because the business climate for the motor vehicle market is harsh, there is little probability that this latent demand will become real demand.

The present stagnation of motor vehicle sales must be mainly due to such economic factors as the decline in consumer confidence and such structural factors as the public perception of car ownership. As regards economic factors, consumer confidence has been dampened by (1) the slowdown in take-home income growth, (2) the increased opacity of the medium- and long-term prospects for the growth of household income and (3) the reverse assets effect arising from the decline in asset values since the bubble's collapse. As regards structural factors, as the sense of values among people has diversified, the number of people who consider automobiles to be "assets" and renew their cars at short intervals has decreased, and the number of people who regard automobiles as "footwear" has increased. This change in perception has caused a structural change, resulting in the same vehicles coming to be used for many more years than in the past, and the core of car demandshifting from brand-new vehicles to used cars.

The above factors behind the current stagnation in car sales will not change much in fiscal 1998, and renewals of vehicles purchased during the bubble period will begin to quicken, if at all, after fiscal 1999.

The specifications for minicars will be amended in October 1998 to expand the length by 10 centimeters and the breadth by 8 centimeters. After the past amendment to the specifications, the market values of minicars rose, and demand for them increased. However, the coming amendment will not directly contribute to the improvement of minicars' attractiveness, because its purpose is to ensure driver safety at the time of a collision. Therefore, it would be premature to predict minicar demand in fiscal 1998, since neither the prices nor the value of new minicar models are known yet. Accelerated demand for old models may arise this coming autumn as the effect of marketing new models will begin to be seen conspicuously after October. At any rate, demand for minicars will show a peak and a trough around October.

Exports of completed vehicles will be affected by the yen-dollar rate but will be kept at a level close to 4.42 million units. Thus, the decrease will be small.

The prospects for overseas markets in 1998 are mixed. U.S. and Western European markets will retain some strength, but the ASEAN market will possibly decline to less than half the 1997 level because (1) the ASEAN countries' financial systems for backing up sales are in paralysis, and (2) the rise in the cost of procurement due to the depreciation of local currencies has made major markups unavoidable.

Regarding the exports of completed vehicles in fiscal 1998, there are several factors that may cause a decrease, such as (1) a sharp decline in exports to ASEAN countries, (2) the existence of models where exports from Japan to third countries will be switched to exports from ASEAN and (3) the existence of models where exports from Japan to Europe will begin to be switched to production in Europe in the second half of fiscal 1998. If the yen-dollar rate remains stable and Japanese vehicles retain their price competitiveness in foreign markets, however, the decrease in exports of completed vehicles from Japan will be small. Reasons supporting this forecast are that: (1) exports to ASEAN have been small in number from the beginning and already began decreasing in the second half of fiscal 1997, and thus the decrease in fiscal 1998 will be limited, (2) the destinations of exports from ASEAN bases and the range of models are limited and, accordingly, the number of vehicles exported from ASEAN will decline, (3) some new types of cars, including sports utility vehicles, will begin to be exported, and (4) automakers will endeavor to maintain export numbers at present levels while growth in domestic demand remains small.

All told, domestic production of completed vehicles will show a fractional decline to about 10.5 million units as a decrease in exports in terms of number will offset a small gain in stagnant domestic sales.

The third session of the Conference of the Parties (COP 3) to the United Nations Framework Convention on Climate Change (UNFCCC), held in Kyoto in December 1997, ended by adopting the Kyoto Protocol, which demands that developed countries reduce greenhouse gas emissions by an average of 5.2% during 2008-2012, and that Japan reduce its discharge of the same gases by 6% during the same period, using 1990 emissions as the standard. Intensification of environmental regulations governing motor vehicle exhaust fumes throughout the world will be unavoidable hereafter, and automakers will have to endeavor to further improve the fuel efficiency of internal combustion engines and develop drive systems that use non-oil energy. There are several methods to cope with the environmental requirements, including the production of hybrid vehicles already on sale. Since each has merits and demerits, automakers are engaged in research and development taking multiple approaches simultaneously. Among the manufacturers of completed cars, however, a wide difference in the progress in research and development is arising. There is a strong probability from a medium- or long-term viewpoint that existing technologies and improvement of them will not be able to meet environmental requirements when they are later intensified. In that event, the ability to meet environmental requirements will decide the fate of each automaker.

(Okada Mitsuhiro, senior economist)

Recent Supply and Demand for Automobiles

(Unit: 1,000 vehicles)

	FY 1995 (result)	FY 1996 (result)	FY 1997 (estimate)	FY 1998 (forecast)
Domestic demand	6,896	7,288	6,275	6,400
Exports	3,624	3,848	4,672	4,420
Domestic production	10,086	10,612	10,776	10,470