

# Economic Measures Generate More Public Works

## Recent trends

### *Slight shrinking of the construction market*

Estimates show that construction investment in fiscal 1997 was ¥76.5 trillion (nominal value), a significant decrease of 7% compared to the previous year. The number of new housing starts recoiled after the purchasing rush prior to the consumption tax increase the previous year, and this effect, combined with prevalent concerns in the latter half of the year over the future of the economy, resulted in a decrease from 1.63 million starts in the previous year to only 1.33 million in fiscal 1997. The non-housing sector saw a dramatic increase in the construction of large stores due to deregulatory measures, but the favorable trend toward facility investment in the manufacturing industry, evident in the first half of the year, began to wane in the second half. Even office building construction, which appeared to have hit bottom, made only minor progress toward recovery.

Government construction investment, which has made up for the failing private sector since the speculative bubble burst, initially has had to face budget reductions due to stringent fiscal regulations. Consequently, a drop of about 3% is expected from the previous year.

### *Business performance increases difficulties*

A look at the construction performance of 79 First Section-listed general contractors shows that after the market hit bottom in fiscal 1994, public works projects bolstered sales, which recovered to ¥26.3 trillion in fiscal 1996 (a 3.8% increase over the previous year). However, mid-year sales in fiscal 1997 once again dropped to ¥10.2 trillion (a 4.3% decrease from the previous year), reflecting a decrease in public works projects early in the year. As competition has grown more fierce in the private construction sector, the ratio of gross profits to sales has worsened from 12.4% in fiscal 1992 to 10.4% in fiscal 1997, thereby threatening to negate the bolstering effect of public works construction.

## Future outlook

### *Construction investment rebounds slightly*

In fiscal 1998, initially budgeted expenses for public works projects costs were 7.8% less than the previous year, but forecasts suggest that due to the comprehensive economic measures announced on April 24, 1998, the combined budget for national and local public works projects will increase to ¥7.7 trillion, thereby reviving government construction investment. Still, with the future of the economy yet so uncertain, recovery in the private sector is not expected to proceed strongly. Given these conditions, construction investment (nominal value) in fiscal 1998 is expected to increase slightly to ¥77.1 trillion (up 0.8% over the previous year).

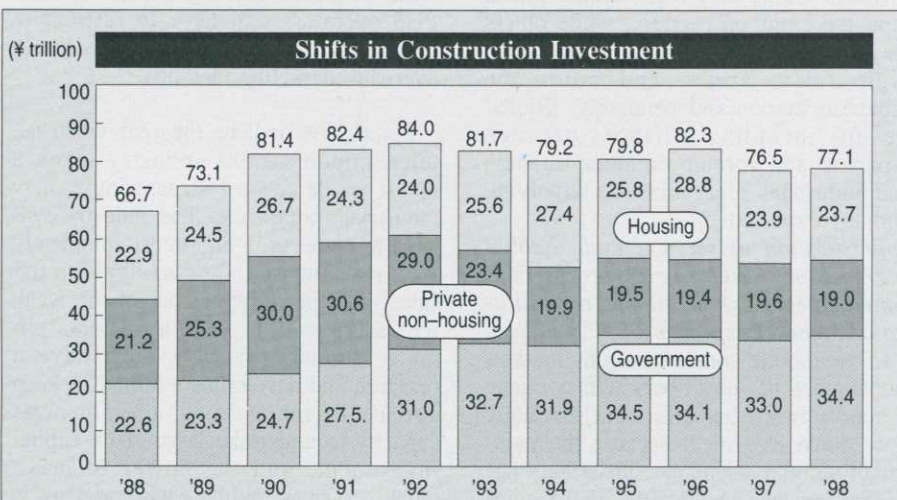
### *Problems facing the construction industry: Need for greater managerial efficiency*

A temporary bolstering effect can be anticipated due to increased public investment, but the inevitably fierce bidding competition in the weaker private sector will require that the construction industry continue to battle decreasing sales and low profit ratios.

This environment poses numerous problems for construction companies. As full-fledged recovery from the bubble period is still underway, it is essential to plan for further pressures on sales prices and general management expenses, as well as pressures on interest-bearing loans due to poor asset management. Also, though low-profit bids have been necessary up until now, future bidding will most surely have to emphasize profitability.

Some companies have undergone major restructuring based on their fiscal 1997 performance, and are striving to further improve their managerial efficiency. Such behavior can be expected across the entire industry.

(Koike Keigo, senior economist)



Sources: Compiled by the Industrial Bank of Japan Industrial Research Department from the Ministry of Construction's "Estimated Investment in Construction in Fiscal 1997." Fiscal 1996 figures from the Research Institute of Construction and Economy. Figures for fiscal 1997 and onward are estimates from the Industrial Research Department of the Industrial Bank of Japan.