How Companies View the Prolonged Deflation —The Nissay Business Conditions Survey (February 2002)

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1. Introduction

The consumer price index has declined for three straight years since 1999, and shows no sign of abating in 2002 as deflation continues to plague the economy. The impact on companies has been profound. While benefiting from lower costs for parts and materials, companies are also struggling with weak sales prices and rising labor and real interest costs.

The latest Nissay Business Conditions Survey, conducted jointly by Nippon Life Insurance Co. and NLI Research Institute in January and February 2002 (with 3,361 companies responding nationwide), examines how companies view the deflationary economy and its impact on business.

According to the results, over 80% of companies report declining sales prices, and believe that deflation has had a negative effect on business. Looking ahead, a pessimistic mood prevails that deflation will linger, including 37% who predict deflation to continue for at least three more years. As to causes of declining sales prices, over 50% cite domestic competition, while 30% cite weak demand. Anti-deflation measures being taken include reducing cost of materials, adding more value to products and services, and cutting labor cost.

2. Sales Prices Decline at Over 80% of Companies

Regarding sales prices of their own products or services, significantly more companies report a downtrend (81.05) than otherwise (17.9%; Figure 1).

By industry, sales price declines are most pronounced in nonferrous metals and metal products (93.3%), electrical machinery (92.3%), construction and installation (88.1%), and machinery and precision instruments (87.8%). On the other hand, price declines are relatively less pronounced in electric power, gas, and water (53.7%), and personal services (62.7%).

By company size, while no clear pattern emerges, large companies (83.6%) tend to be slightly more affected than second-tier companies (80.6%) and small and medium companies (81.0%).

Figure 1 Are Sales Prices Declining?

(%)

	Yes	No
All industries	***81.0***	17.9
Selected industries		
Nonferrous metals, metal products	***93.3***	6.7
Machinery, precision instruments	87.8	11.0
Electrical machinery	***92.3***	7.7
Construction, installation	***88.1***	10.4
Personal services	62.7	37.3
Electric power, gas, water	53.7	41.5
Company size		
Large	***83.6***	15.1
2nd-tier	80.6	18.0
Small & medium	81.0	18.3

Note: Numbers may not add up to 100 due to incomplete responses.

3. Declining Sales Prices Blamed on Domestic Competition

As to the cause of declining sales prices, the most prominent is competition with other domestic companies (54.0%), followed by weakness in demand (30.3%). Few companies cite inexpensive imports (9.5%) or distribution improvements such as electronic commerce (0.5%; Figure 2).

By industry, demand weakness is the most prominent cause in real estate (48.6%) and steel products (40.5%). Domestic competition is cited most in electric power, gas and water (77.3%), foods (68.9%), communication (64.7%) and personal services (63.5%). Interestingly, inexpensive imports seem to have had little impact except in textiles and apparel (61.1%), where the effect is large.

While no clear patterns emerge by company size, domestic competition tends to increase slightly as a factor with company size, while weak demand and inexpensive imports tend to decrease. While few companies overall cite e-commerce and other distribution innovations, the response of large companies (1.5%) is relatively high.

Figure 2 Causes of Decline in Sales Prices

(%)

	Domestic competition	Demand decline	Import competititon	Distribution (e-business, etc.)	Other
All industries	***54.0***	***30.3***	9.5	0.5	5.6
Selected industries					
Textiles & apparel	13.9	25.0	***61.1***	0.0	0.0
Steel products	38.1	***40.5***	9.5	0.0	11.9
Foods	***68.9***	17.0	9.6	0.0	4.4
Communication	***64.7***	23.5	0.0	0.0	5.9
Real estate	32.4	***48.6***	2.7	0.0	16.2
Personal services	63.5	26.9	0.0	0.0	9.6
Electric power, gas, water	***77.3***	4.5	0.0	0.0	18.2
Company size					
Large	58.8	27.8	6.2	***1.5***	5.7
2nd-tier	54.0	29.4	9.6	0.3	6.5
Small & medium	53.4	30.8	9.8	0.5	5.3

Note: Numbers may not add up to 100 due to incomplete responses.

4. 37% Predict Three or More Years of Deflation

The most common outlook is for deflation to continue at least three more years (36.7%), followed by up to two years (26.8%), and up to three years (20.1%). Few companies predict a quick end to deflation: 10% believe it will continue up to one year, 0.8% that it will continue up to half a year, and 3.7% already see signs of a turnaround (Figure 3).

By industry, three or more years of deflation are expected by the majority of companies in textiles & apparel (58.3%), real estate (54.1%), and transport equipment (52.6%). On the other hand, relatively few companies share this outlook in steel products (14.3%), restaurant (21.2%) and foods (26.7%).

Figure 3 Outlook for Sales Price Deflation

(%)

	At least 3 more years	Up to 3 more years	Up to 2 more years	Up to 1 more year	Up to half a year	Now ending
All industries	***36.7***	20.1	26.8	10.0	0.8	3.7
Selected industries						
Textiles & apparel	***58.3***	5.6	25.0	8.3	0.0	2.8
Steel products	14.3	21.4	26.2	***33.3***	2.4	0.0
Foods	26.7	22.2	26.7	11.1	0.7	5.9
Electrical machinery	42.6	14.8	27.2	9.5	1.2	4.1
Transport equipment	***52.6***	25.0	17.2	2.6	0.0	1.7
Real estate	***54.1***	21.6	21.6	2.7	0.0	0.0
Restaurant	21.2	24.2	21.2	18.2	3.0	***12.1***
Company size						
Large	***39.7***	16.5	25.3	11.3	1.0	2.1
2nd-tier	36.5	19.8	25.3	10.5	1.0	5.2
Small & medium	36.4	20.6	27.5	9.7	0.7	3.3

Note: Numbers may not add up to 100 due to incomplete responses.

5. 80% Say Deflation Hurts Business

Over 80% of companies report being negatively affected by deflation (34.1% negatively affected, 46.1% somewhat negatively).

By industry, the negative impact is most widespread in mining, oil, glass & ceramics (91.4%), followed by furniture, fixture, and wood products (90.5%), textiles & apparel (89.6%), nonferrous metals and metal products (86.5%). On the other hand, the impact is less widespread in electric power, gas and water (41.5%), finance (62.0%), and information services (66.2%).

Figure 4 Effects of Deflation on Business

(%)

	Positive	Somewhat positive	No effect	Somewhat negative	Negative
All industries	0.4	2.6	15.8	***46.1***	***34.1***
Selected industries					
Mining, oil, glass & ceramics	0.0	4.3	4.3	50.0	***41.4***
Textiles & apparel	0.0	2.1	8.3	33.3	***56.3***
Nonferrous metals, metal product	0.0	3.0	9.7	***50.7***	35.8
Furniture, fixture, wood products	0.0	9.5	0.0	***52.4***	38.1
Information services	1.3	3.9	27.3	***50.6***	15.6
Finance	0.0	***10.3***	27.6	44.8	17.2
Electric power, gas, water	0.0	7.3	43.9	24.4	17.1
Company size					
Large	0.9	3.0	12.9	50.0	31.9
2nd-tier	0.4	3.2	16.4	44.6	34.1
Small & medium	0.4	2.3	15.9	46.3	34.2

Note: Numbers may not add up to 100 due to incomplete responses.

6. Main Benefit of Deflation: Lower Cost of Materials

Among companies benefiting from deflation, the most common benefit is lower cost of materials (59.4%), followed by increased demand due to lower prices (28.7%), lower nominal interest rates (19.8%), lower real estate prices and rents (17.8%), and lower labor cost of new workers (17.8%; Figure 5).

By industry, increased demand due to lower prices is most pronounced in services (42.9%), while lower cost of materials is cited most in process manufacturing (85.7%). Lower real estate prices and rents are cited most in nonmanufacturing (22.4%), while lower labor cost of new workers is most prominent in services (21.4%), and lower nominal interest rates in materials manufacturing (27.3%).

By company size, lower cost of materials is cited less by large companies (33.3%) than second-tier (63.3%) and small and medium companies (61.3%).

Figure 5 Positive Effects of Deflation

(%)

	Lower materials cost	More demand due to price decline	Lower nominal interest rate	Lower real estate prices & rent	Lower cost of new labor	Other
All industries	***59.4***	***28.7***	19.8	17.8	17.8	21.8
Selected industries						
Manufacturing	76.9	23.1	15.4	10.3	17.9	12.8
Materials	54.5	9.1	***27.3***	9.1	18.2	27.3
Processing	***85.7***	28.6	10.7	10.7	17.9	7.1
Nonmanufacturing	46.6	32.8	22.4	***22.4***	17.2	29.3
Services	42.9	***42.9***	7.1	21.4	***21.4***	35.7
Company size						
Large	33.3	33.3	0.0	***33.3***	***22.2***	44.4
2nd-tier	63.3	26.7	20.0	20.0	13.3	10.0
Small & medium	61.3	29.0	***22.6***	14.5	19.4	24.2

Note: Numbers may not add up to 100 due to incomplete responses.

7. Main Drawback of Deflation: Lower Sales Prices

Among companies hurt by deflation, the most common complaint is decline in sales prices (77.9%), followed by slower decline in materials cost relative to sales price (47.5%), and high labor cost of present workers (29.3%; Figure 6).

By industry, the decline in sales prices is cited most by nonferrous metals and metal products (84.5%) and textiles & apparel (83.7%). The slow decline in cost relative to sales price is most prominent in foods (59.9%) and nonferrous metals and metal products (55.2%), while high labor cost of present workers is cited most by information services (43.1%), steel products (41.5%), and restaurant (40.0%) industries.

By company size, the slower decline in cost relative to sales price tends to affect smaller companies more (large 41.1%, second-tier 44.4%, small and medium 49.4%). On the other hand, high labor cost of present workers is slightly more common at large companies (33.2%) than second-tier (32.0%) and small & medium companies (27.8%).

Figure 6 Drawbacks of Deflation

(%)

	Lower sales prices	Costs decline by less than sales price	High cost of present labor	Property price decline	High real interest rate	Other
All industries	***77.9***	***47.5***	29.3	9.9	2.8	3.9
Selected industries						
Textiles & apparel	***83.7***	46.5	39.5	11.6	0.0	2.3
Steel products	80.5	36.6	***41.5***	7.3	2.4	0.0
Nonferr. metals, metal products	***84.5***	***55.2***	28.4	6.0	0.9	0.0
Foods	81.0	***59.9***	21.2	7.3	0.7	2.9
Real estate	69.8	23.3	7.0	***58.1***	4.7	0.0
Restaurant	80.0	42.9	***40.0***	2.9	0.0	2.9
Information services	74.5	33.3	***43.1***	2.0	5.9	7.8
Company size						
Large	78.4	41.1	33.2	***13.7***	3.7	5.3
2nd-tier	81.4	44.4	32.0	9.4	2.1	3.8
Small & medium	76.6	49.4	27.8	9.6	2.9	3.9

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8. Public Policy Expectations: No Consensus

With regard to anti-deflation policies that companies seek of the government, additional public works spending (21.9%) is almost evenly balanced with further monetary easing (21.1%), followed in third place by yen depreciation (13.1%). On the other hand, as many as 12.6% of companies see no need for special measures (Figure 7).

However, expectations vary widely by industry. A weaker yen is favored by textiles & apparel (31.3%), machinery and precision instruments (23.2%), and transport equipment (22.6%). On the other hand, further monetary easing is favored by real estate (37.7%), while additional public works spending is favored by construction and installation (60.1%), mining, oil, glass & ceramics (51.4%), and steel products (42.9).

Figure 7 Expectations Regarding Public Policy

(%)

	More public works	More monetary easing	Weaker yen	None	Other
All industries	***21.9***	***21.1***	13.1	12.6	21.6
Selected industries					
Mining, oil, glass & ceramics	***51.4***	11.4	7.1	10.0	14.3
Textiles & apparel	8.3	27.1	***31.3***	16.7	12.5
Steel products	***42.9***	14.3	14.3	8.2	8.2
Machinery, precision instruments	24.9	17.7	***23.2***	8.8	18.2
Transport equipment	14.6	25.5	***22.6***	14.6	13.1
Construction, installation	***60.1***	8.8	6.2	5.2	14.5
Real estate	13.2	***37.7***	7.5	13.2	20.8
Company size					
Large	18.1	18.5	14.2	9.9	28.0
2nd-tier	21.9	19.1	14.3	12.2	22.8
Small & medium	22.2	22.2	12.5	13.0	20.6

Note: Numbers may not add up to 100 due to incomplete responses.

9. 30% Emphasize Long-Term Growth in Value Added

As for measures already implemented to combat deflation, the most common is reducing the cost of materials (31.4%), followed by increasing value added to products and services (26.7%), reducing labor cost (24.7%), and new product development (21.9%; Figure 8).

By industry, significantly high responses are seen for new product development by textiles & apparel (41.7%) and electrical machinery (35.5%); increasing value added to products and services by textiles & apparel (41.7%); reducing cost of materials by electrical machinery (41.5%); and reducing labor cost by electrical machinery (33.3%).

By company size, large companies generally tend to be more aggressive in implementing anti-deflation measures.

Figure 8 Anti-Deflation Measures Already Being Implemented

(%)

	Cut input cost	Add more value	Cut labor cost	New prod. dev.	Pay down debt	Trim invest.	Expand sales volume	Sell idle assets	None	Other
All industries	***31.4***	***26.7***	***24.7***	21.9	15.0	13.8	12.1	3.3	5.4	0.9
Selected industries										
Textiles & apparel	22.9	***41.7***	25.0	***41.7***	8.3	8.3	6.3	2.1	0.0	0.0
Steel products	30.6	14.3	30.6	12.2	***22.4***	22.4	10.2	4.1	6.1	2.0
Electrical machinery	***41.5***	22.4	***33.3***	***35.5***	6.0	16.9	9.8	2.2	2.2	1.1
Construction	39.9	19.7	31.1	18.1	13.0	11.4	10.9	6.7	7.3	0.0
Communication	4.8	28.6	14.3	19.0	9.5	***28.6***	***23.8***	0.0	9.5	0.0
Real estate	18.9	13.2	22.6	1.9	18.9	17.0	9.4	***13.2***	***17.0***	1.9
Information services	20.8	***41.6***	5.2	20.8	10.4	7.8	3.9	2.6	10.4	0.0
Company size										
Large	25.9	30.6	30.6	25.0	17.7	19.4	10.8	5.6	4.3	0.9
2nd-tier	34.8	29.7	24.7	23.0	15.1	16.1	10.5	3.7	3.1	1.1
Small & medium	30.8	25.3	24.0	21.3	14.7	12.3	12.8	2.9	6.4	0.7

Notes: Numbers may not add up to 100 due to incomplete responses.

As for measures planned in the medium to long-term future, there is a slight shift in priorities: the most cited measure is increasing value added to products and services (30.8%), followed by reducing labor cost (28.3%) and new product development (25.1%; Figure 9).

By industry, significantly high responses are seen for increasing value added by electrical machinery (43.7%) and machinery and precision instruments (42.5%); reducing labor cost by steel products (49.0%) and warehousing & harbor transport services (39.3%); and developing new products by chemicals (47.9%), machinery and precision instruments (47.5%), and electrical machinery (44.8%).

Figure 9 Anti-Deflation Measures Planned for the Future

(%)

	Cut input cost	Add more value	Cut labor cost	New prod. dev.	Pay down debt	Trim invest.	Expand sales volume	Sell idle assets	None	Other
All industries	21.6	***30.8***	***28.3***	***25.1***	15.5	10.4	8.2	8.4	4.2	1.9
Selected industries										
Steel products	12.2	24.5	***49.0***	20.4	22.4	12.2	10.2	8.2	2.0	4.1
Chemicals	15.4	37.3	20.1	***47.9***	8.9	8.3	8.9	2.4	3.0	0.0
Machinery, precis. instru	21.5	***42.5***	22.7	***47.5***	9.4	7.2	7.2	3.9	2.2	1.1
Electrical machinery	20.2	***43.7***	21.9	***44.8***	7.1	7.1	7.1	4.4	2.2	2.7
Warehous. & harbor tran.	17.9	26.6	***39.3***	6.6	***23.1***	***13.5***	7.0	***13.1***	4.8	1.7
Information services	20.8	***49.4***	24.7	18.2	7.8	6.5	6.5	3.9	6.5	2.6
Specialized services	17.6	32.4	38.2	20.6	2.9	2.9	5.9	2.9	2.9	0.0
Company size										
Large	21.6	31.9	25.0	27.2	18.5	12.5	7.8	11.2	3.0	2.6
2nd-tier	21.1	33.3	32.1	26.7	16.0	11.2	6.7	9.5	2.9	1.8
Small & medium	21.9	29.7	27.3	24.3	15.0	9.8	8.8	7.6	4.8	1.9

Note: Numbers may not add up to 100 due to incomplete responses.

The Nissay Business Conditions Survey

Survey period: From mid January to end of February 2002

Sample size and composition: 3,361 companies, as follows.

By Company Size

	No. of companies	Composition (%)
Large	232	6.9
Second-tier	839	25.0
Small & medium	2,279	67.8
No response / other	11	0.3

By Region

	No. of companies	Composition (%)
Hokkaido	88	2.6
Tohoku	213	6.3
Kanto	765	22.8
Koshinetsu / Hokuriku	369	11.0
Tokai	538	16.0
Kinki	655	19.5
Chugoku	306	9.1
Shikoku	130	3.9
Kyushu	200	6.0
No response / other	97	2.9