Trade-ins Key to Domestic Market Recovery

The low demand for automobiles during the beginning of fiscal 1994 can be attributed to lower consumer earnings as the long recession brought reductions in overtime pay and salary bonuses. But the enforcement of stricter over-loading regulations for trucks in May 1994 brought a comeback in demand for standard-sized trucks. A so-called "trade-in demand" developed in the summer when cuts in income and resident taxes gave consumers the opportunity to trade-in their old cars for new models. Consequently, domestic demand, measured in number of vehicles sold, for fiscal 1994 is expected to show a 3.3% increase compared with fiscal 1993.

Demand was most striking in two areas: so-called "recreational vehicles" (station wagons, family vans, jeeps, etc.) and imported cars. Not only did the station wagon market expand, but off-the-road 4WD vehicles—which went through a phase of astronomical growth—have found a broader customer base with the development of new models. Although it depends somewhat on one's definition of what a recreational vehicle is, in fiscal 1994 almost 30% of passenger cars purchased fell into this category.

In the import field, foreign automakers took advantage of the strong yen to mount a low-price strategy and also widened their network of dealers, thereby greatly increasing sales. Japanese automakers also increased imports of foreign-made vehicles, concentrating mainly on makes not built in Japan. Imported car sales far surpassed last year's mark with approximately 300,000 vehicles sold.

Meanwhile, in the fiscal 1994 export market, production by Japanese factories in the United States could not keep up with the major expansion of the U.S. car market, thereby helping to keep Japanese exports on an even keel. In Europe and Asia, however, a continuing drop in sales of Japanese imports was inevitable as the high yen eroded the competitiveness of Japanese cars and overseas production by Japanese automakers increased.

In fiscal 1994, domestically produced vehicles will probably fall to 10.5 or 10.6 million units. The resurgence of domestic demand will be hard-pressed to compensate for the drop in exports. Although car makers are struggling to cut cost price through various restructuring efforts, the drop in sales volume on top of a drop in net profits due to the strong yen make any substantial increase in profits difficult.

Photos: Toyota Motor Corp.

Upper right: Toyota's popular recreational vehicle, Land Cruiser. Above: Toyota Motor Corp. of Australia Pte., Ltd.

Domestic outlook

Although the pace of the economic recovery in fiscal 1995 will not be rapid, it is expected to be enough to boost domestic demand for automobiles over the fiscal 1994 mark. The key element will be the appearance of a vehicle replacement demand market, as consumers trade-in their old cars and buy new models. The number of passenger cars due for their five-year inspection is predicted to be 9.5% higher in 1995 than in 1994, and cars due for seven-year inspections are expected to be up 14.1%. Over the past two to three years, the trade-in market has not been a significant factor because of the chilling effects of the economic retreat. Now, however, this market is expected to reappear because expectations are growing that the economy has emerged from the downtrend and is turning toward recovery, resulting in greater consumer confidence. Car owners have been holding on to their cars longer and waiting for a good time to trade them in.

The negative elements in the fiscal

Automobile Supply and Demand

(10,000 units)

	FY1993	FY1994 (estimated)	FY1995 (anticipated)
Domestic Demand	639	660	696
Exports	462	430	420
Production	1,085	1,057	1,083

Note: Domestic demand includes imported vehicles

1995 market for commercial vehicles will be the continuing harsh business climate surrounding vehicle-user businesses and the higher price tags on new vehicles due to the necessity to incorporate new technology to comply with vehicular emissions regulations. There are also several positive elements such as requirements in Tokyo and Osaka to replace old vehicles with vehicles that meet local NOX regulations, a high demand in the first term for vehicles built before application of the 1994 emissions regulations (September 1995), and the introduction of new large-sized vehicles after the easing of gross vehicle weight limitations.

The demand for ordinary trucks was high in fiscal 1994 due to the special market created by more rigidly enforced over-loading regulations and a run on trucks built before application of short-term vehicular emissions regulations. Consequently, demand in fiscal 1995 for commercial vehicles will quite likely have a hard time growing much over 1994 levels. In the small truck category, a trade-in market demand paralleling that of passenger cars may develop.

So-called "recreational vehicles" should pioneer a new market in fiscal 1995 with the introduction of vehicles based on entirely new concepts. Although there is now a fledgling recovery in passenger cars in the sedan class, recreational vehicles are likely to continue to account for a greater share of vehicles used as passenger cars.

The fiscal 1995 demand for compact cars is apt to be influenced by a movement toward requiring proof of parking space in order to purchase a car. A possible schedule of implementation for this requirement is being studied: in cities with over 300,000 inhabitants and some Tokyo and Osaka metropolitan areas by 1996, in cities with over 200,000 inhabitants by 1999, and in cities with over 100,000 inhabitants by 2001. When this proof-of-parking requirement was enacted in Tokyo's 23 wards and in Osaka City in 1991, it had a great impact on demand for cars in these areas. With plans for wider enactment in 1996, there is the potential for a small run on small cars starting at the end of 1995, but over the long term (beginning in 1996) the law will probably have a negative effect on the demand for compact cars.

Exports

Conditions surrounding fiscal 1995 exports of automobiles are contradictory. On the positive side, the United States and Europe—home to the world's largest automobile markets—are on the road to recovery. In the U.S. market, in particular, the market continues to expand despite worrisome indicators, such as rising interest rates. The market has the real potential to grow to 16 million cars. The degree to which demand outstrips supply from U.S. factories may grow, making it necessary to import more cars from overseas.

On the negative side, there are fears that Japan's market share will fall as the strong yen undermines the price competitiveness of Japanese cars, and exports will be replaced by local production. Exports of vehicles will probably decline slightly regardless of the worldwide market recovery. Looking on the bright side, the increase in overseas production should boost Japanese parts exports.

Since the increase in domestic demand in fiscal 1995 is forecast to exceed the drop in exports, domestic vehicle production should turn toward recovery. However, a recovery in exports is difficult to imagine given the abundance of factors holding exports down. Consequently, domestic production in fiscal 1995 will probably only climb back up to 1993 production levels. Car makers cannot expect a large-scale expansion in volume and should concentrate on continuing to cut costs in order to secure profits.

Looking at the mid-term outlook, domestic production can be expected to gradually recover, but considering the expansion of overseas production, a major recovery in exports is unlikely. Production levels are apt to remain well below the highs set during the period of economic expansion. In addition to the restrictions on the number of vehicles produced, prices are not expected to rise at the rates they have in the past. On the contrary, a slight drop in prices is expected.

During the bubble period, the unit price of car sales rose with a shift toward higher-end models, increased sales of luxury cars, and increased installation of optional equipment. All these factors were fostered by stable growth in disposable income, increasing land and stock prices and the discontinuance of excise taxes. Now, however, the number of consumers whose bottom-line is cost performance is growing as overtime pay and bonuses are cut and land and stock prices drop.

Consequently, prices are being held to a minimum even in the luxury class as the price of imports continues to fall due to the strong yen and changes in importers' sales strategy. There are some unavoidable factors that increase the cost of new cars, such as improvements in equipment, for example air bags and anti-lock brake systems, and engine improvements to meet environmental regulations. With the changing marketing environment, however, the necessity of excess equipment will be questioned as consumer orientation toward price becomes more entrenched.

An increase in automobile prices is unlikely. The question is just how much car makers—having been prevented from raising prices—will lower costs in order to maintain profits. Cost-cutting will not stop with traditional cost-price reductions. Development of new cars is called for which has cost-cutting in mind from the design stage onward. JJTI

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