Domestic Demand Bullish, Sales Competition Severe

Trends in fiscal 1996

Domestic automobile sales took a turn for the better in fiscal 1996. A total of 7.22 million vehicles are expected to have been sold by the end of fiscal 1996, 4.7% more than in FY1995. Domestic sales in the first half of the year were a mere 1.4% higher than during the same period the year before, but the year-on-year increase shot up to 7.7% in the second half of the year. Heavy sales in the second half were linked to a sales offensive that used margins coming from the weaker yen to discount prices and to a segment of the market looking to buy cars before the proposed raising of the consumption tax rate. Although many consumers didn't regard the pending 2% increase in the tax as a major incentive, due to the continued increase of price discounts above 2%, auto manufacturers still aggressively poured money into sales promotions targeting the pre-consumption tax hike market in hopes of maintaining or expanding their market share. Consequently, demand tied to pre-tax buying is thought to have reached the scale of around 150,000 cars, providing a roughly 2% boost in overall demand in 1996. Even if this particular element is ignored, growth in domestic demand was still around 2.5%, meaning that the demand doldrums in the first half of the fiscal year were only a temporary glitch. It seems that the recovery in domestic demand that began in fiscal 1994 continues basically unchanged.

The fiscal 1996 domestic car market has two primary characteristics. First is the intensification of domestic competition for sales. Due to gains in profits because of the weaker yen, automakers were able to invest in expanding domestic sales, which sparked an intense battle over the domestic market.

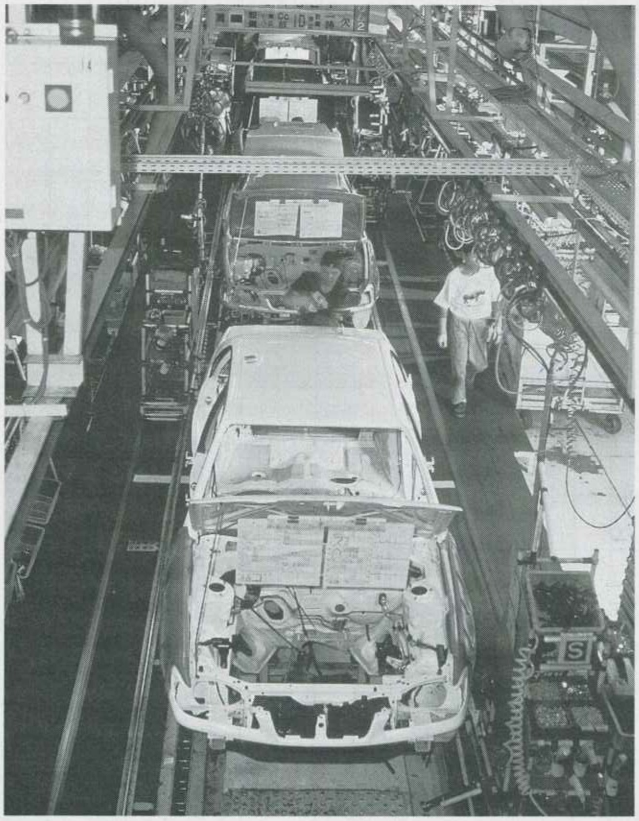

Photo: Toyota Motor Corp.

Replacement demand for autos sold in bubble period solid.

The second factor was the continuing boom in the RV market. Many new models were introduced in fiscal 1996 in this area and most were hits. Consequently, the sedan's proportion of total car sales fell.

The downward trend in finished car exports beginning in FY1985 began to turn upward in FY1995, hitting 3.7 million units. Factors behind the 1995 upturn were: (1) improve price competitiveness abroad due to the weakening of the yen against the dollar; (2) the absence of an overseas shift in production of high-volume sales vehicles, since no new large-scale overseas plants were established or placed on line; and (3) a recovery trend, although slight, in the European and U.S. car markets.

Domestic finished car production has been falling ever since peaking at 13.59 million in FY1990, dipping to 10.09 million units in FY1995. In fiscal 1996, however, it appears that production will have risen for the first time in six years, bouncing back to around 10.5 million cars.

Profits by finished car makers have also greatly recovered, thanks to a net increase in export credits due to a weaker yen and implementation of rationalizing measures such as cost price reductions. Although the total ordinary income of the 11 finished car makers won't have reached the high recorded in FY1989, it is still expected to have hit the ¥1 trillion level. Most of the net increase in export credits, which arose when the drop in the yen rate exceeded the initial exchange rate estimates used in finished car makers' books, was funnelled into lowering sales prices abroad and providing sales incentives to car dealers in Japan. One way or another, the weak yen had a major impact on the Japanese auto industry.

While manufacturers with popular models saw hefty profits through large volume sales and a stable per unit margin, makers which did not come out with popular models and truck makers with low export ratios stuck with sacrificed sales did not see much increase in profits in FY1996. Although automakers overall experienced increased profits, there was a wide gap between the profits of individual makers.

Outlook for fiscal 1997

Although a temporary backlash in domestic automobile sales is expected in fiscal 1997, due to the effects of pre-consumption tax hike demand, there is a strong possibility that sales will continue to grow. This growth is tied to demand coming from consumers who are ready to replace cars bought during the bubble era and due to continued sales promotions with discounts offered by finished car makers. Thus, basically, domestic sales have a strong foundation. It is estimated that a demand level of 7.11 million units, a drop of 1.5% from FY1996 levels, will be maintained. Although 7.11 million units is less than the FY1996 number, if the demand shift of approximately 150,000 vehicles caused by the raising of the consumption tax hike is accounted for, the actual year-on-year change is predicted to be a gentle increase of just under 3% from the previous fiscal year.

The basis for the belief that actual domestic demand will continue to recover, despite the fact that the future direction of the economy remains unclear, is the highly reliable replacement demand for cars purchased during the bubble period. During the five years between 1988 and 1992, 36.31 million new automobiles were sold in Japan. During the next five years (1993–1997), only 34.33 million vehicles will be sold—assuming sales of 7.22 and 7.11 million in FY1996 and FY1997.

Demand for new cars comes from two kinds of customers—those replacing an old car for a new one and those buying a first or additional vehicle. Even considering the levelling off of growth in vehicle possession, a first or additional-car demand level of around 9 million units is expected for the 1993–97 period. If these 9 million cars are subtracted from the 34 million total new car sales in the five-year period, it leaves a replacement demand of around 25 million cars. Assuming that the replacement cycle is five years, which is slightly shorter than the real figure, simple mathematics indicates that around 11 million of the 36 million new vehicles sold during the 1988–92 bubble have yet to be traded in for new vehicles.

Of course, in reality, there is no 10 million unit-strong potential replacement demand. The reasons are that (1) in the past, vehicles were usually owned for five to six years before being traded in, but new cars are now being owned for longer periods, (2) some car owners who bought new cars during the bubble period are trading them in for used vehicles and (3) some of the replacement demand was eaten up early on by the shorter, new car purchasing cycle of the bubble period. Nevertheless, significant potential replacement demand is just waiting to materialize once consumers decide that the time is right to trade in their old cars.

Supply and Demand for Automobiles

(units: 1,000 vehicles)

	Fiscal 94	Fiscal 95	Fiscal 96 estimates	fiscal 97 predictions
Domestic demand	6,697	6,896	7,220	7,110
Exports	4,348	3,624	3,700	3,700
Domestic production	10,618	10,086	10,495	10,365

(Note: Domestic demand includes imports.)

RVs stay in good shape.
(Photos: Honda Motor Co., Ltd (left) and Toyota Motor Corp. (right))

Although fluctuations in the exchange rate can influence finished car exports, a level of 3.7 million units should be maintained if the exchange rate in the first half of 1997 is around ¥110 to the dollar and the yen gradually gains strength during the second half.

Looking abroad, a slight reduction in the size of the U.S. market for Japanese cars is expected in 1997, while the dominant view toward the European market is that there will be only slight growth. Consequently, it is hard to foresee appreciable demand expansion in these two markets over the next year. New large-scale overseas production bases by Japanese automakers are not expected to go on line in the next year, and there are no plans for converting domestic production of the 100,000 or so volume sales car models to overseas production. In Asia, there are variations among different countries, but in general, continuing market expansion is forecast and a bullish trend in exports to these countries is expected. All in all, Japanese finished car exports should continue on the pace set in fiscal 1996 as long as the exchange rate is stable and Japan can maintain price competitiveness abroad.

Although this two-year turn-around may be interpreted as a reversal of the downward slide in exports between 1985 and 1995, there is the strong possibility that finished car exports will drop again after fiscal 1998 in the face of rising overseas production.

Any drop in exports in fiscal 1997 should be very small and domestic sales should be about the same as the previous year. Thus, domestic finished car production numbers for fiscal 1997 will probably fall below the previous year's level again. The reduction should be slight, however, and domestic production—predicted at just under 10.4 million cars—should remain above the 10 million mark.

(Okada Mitsuhiro, senior economist)