

# High Domestic Demand Foreseen

The Tokyo Motor Show in the fall of 1995 was strikingly staid compared to previous shows, with hardly no showy concept cars to be seen. The change seemed to reflect the harsh environment that the Japanese automobile industry finds itself in these days. In fiscal 1995, domestic production of finished cars dropped by around 10 million units, mainly due to a plunge in exports of finished cars. It is difficult to foresee a major expansion in production volume for fiscal 1996.

In this paper, I will look back over the automobile industry in fiscal 1995 and look forward to the situation in fiscal 1996.



*Sales of RVs satisfactory.*

## Trends in fiscal 1995

The first matter to address is fiscal 1995's domestic demand. The rapid strengthening of the yen in early spring 1995 not only brought down finished car exports, but dashed cold water on the recovery in domestic car sales. The strong yen, by weakening company earnings, held down household incomes, stimulated unemployment fears and depressed consumer confidence. Thus, in the first half of fiscal 1995, the strong yen weakened the demand for passenger cars, which had finally begun to move toward a recovery. In the latter half of fiscal 1995,

however, demand has been gradually recovering due to a halt in the climb of the yen.

The gulf between passenger car models that sell and those that do not has widened. Whereas demand for many sedan models remained stagnant, many models of the so-called recreation vehicles—station wagons, minivans and off-road four-wheel drives—are experiencing healthy sales.

In the ordinary truck market, the impending implementation of new short-term emission controls in September spurred high demand for inexpensive old-model trucks in the first half of the year. Once the special demand evaporated after the regulations took effect, however, the demand for ordinary trucks fell.

Meanwhile, demand in the small truck category recovered much more slowly than in the ordinary truck category. Since the majority of small truck users come from small and mid-size companies, the slower recovery in small truck demand is thought to be tied to the fact that these companies experienced a slower recovery than large companies.

In 1995, foreign car makers boosted car sales in Japan, helped by the development of a dealership network and competitive pricing as well as the beneficial effects of the strong yen. Japanese car makers also imported more new models produced overseas such as the Avalon, creating a healthy rise in domestic sales of reverse-imports (Japanese cars produced overseas and shipped to Japan for domestic sales) to 400,000 in fiscal 1995.

Looking now at exports, fiscal 1995 exports of finished cars appear to have fallen far short of 4 million at only 3.6 million units. Exports were hurt by the

high yen and expansion of overseas production by Japanese car makers. The drop in exports to the United States, the number one overseas market for Japanese cars, was particularly precipitous. In the first half of fiscal 1995 alone, the number of Japanese exports to the U.S. fell by 220,000 units over the same period in the previous year for a decline of 27%. Hurt by the contraction of the U.S. market, increased production at Japanese plants overseas and the suspension of delivery of luxury cars after the announcement of U.S. trade sanctions in May, Japanese auto exports to the U.S. fell dramatically. Exports to Europe also slowed as Japanese cars' competitiveness weakened vis-a-vis stronger competition from local auto makers. Although exports to Southeast Asia showed firm growth due to expansion of local demand, the drop in exports to China continued. Consequently, total export growth in Asia was slight.

Overall, the slight recovery in the domestic car market could not offset the huge drop in exports and the increase in imports. Fiscal 1995 production of domestically produced finished Japanese cars appears to have fallen to a dramatically low 10 million units, only around 75% of total production during the auto industry's peak years. Domestic automobile assembly plants have thus taken steps to cut production. Few assembly lines that produce car models that enjoy brisk sales are still operating at full capacity, with most lines operating at reduced speed or cutting back from double to single shifts.

## A look at fiscal 1996

Assuming that the economy will experience a gradual recovery in fiscal 1996, domestic demand should exceed the 7 million unit level for the first time since fiscal 1991. Two main factors are contributing to a recovery in domestic demand. First of all, most people who bought cars during the bubble economy



Autumn '95 Tokyo Motor Show not as flamboyant as before.

### Supply and demand for automobiles

(units: 1,000 vehicles)

	fiscal 94	fiscal 95 estimates	fiscal 96 predictions
domestic demand	6,696	6,874	7,150
exports	4,348	3,580	3,425
production	10,618	10,050	10,125

(Note: Domestic demand includes imports.)

are now ready to trade them in, creating a large pool of vehicles that will be bought to replace the trade-ins. In addition, consumers have been putting off replacing their old vehicles during the economic hard times of the past two to three years. Secondly, the increase in the consumption tax rate scheduled to go in effect in April 1997 is expected to generate a slight increase in demand from around January to March 1997.

During the past two to three years, however, consumer confidence was hurt by economic conditions and demand for replacement vehicles did not come to fruition. If recovery in fiscal 1996 is too slow—thereby having an adverse effect on consumer confidence—the lengthening of the replacement cycle will continue and the potential for a replacement demand may lessen.

There will probably be great variability in domestic demand trends among different categories of automobiles. In the ordinary truck category, although the special demand before implementation of the short-term emission controls helped secure a high level of demand in fiscal 1995, a decrease in demand is inevitable in fiscal 1996 without this element.

In the compact car category, demand will almost assuredly undergo a slight decline. The strong sales of new models that incorporate new concepts is expected to gradually diminish. Furthermore, the legal requirement to have a parking place prior to purchasing a car has been

strengthened.

The proportion of so-called recreational vehicles that are used as passenger cars will probably continue to rise, driven by makers' investment in new car concepts and the diversification of consumer needs. As for imported cars, since some models will begin to be imported for the first time, the growth rate will be lackluster, but total demand for imports will rise to a slightly higher level.

There is a strong possibility that fiscal 1996 exports of finished vehicles will be even lower than in fiscal 1995, although this depends ultimately on the yen-dollar exchange rate. As for the overseas market environment in fiscal 1996, many observers expect a recovery, although slight, in demand for automobiles in North America and Europe. Certainly, the Asian market will continue to exhibit healthy expansion. Therefore, there is only a slight chance that total demand in the overseas car market will drop in fiscal 1996 and the overall market environment will not necessarily be poor. However, the environment surrounding Japanese cars is expected to remain severe, with weaker price competitiveness by Japanese cars caused by the past two to three years of a strong yen and the fall of Japanese superiority in non-price competition areas due to the improved quality of European and U.S. cars. In this harsh atmosphere, it will not be easy for Japanese cars to boost their share of the export market. Thus, sales of Japanese cars overseas are not expect-

ed to increase much in the next fiscal year.

Looking next at the supply of Japanese cars, although growth in the number of locally produced units will vary by region, established overseas plants will continue to boost operations, continuing the trend of increased overseas production. Thus, the trend of sending fewer and fewer domestically produced Japanese cars abroad will also continue. Although the drop in the overseas supply of domestically produced units will be smaller than the drop in fiscal 1995, there is a strong chance that finished export units will still fall under 3.5 million units.

If an exchange rate level of around ¥100 to the U.S. dollar is maintained in fiscal 1996, the growth in domestic sales should just barely cover the fall in finished exports, so a slight recovery in domestic production of finished cars can be expected. Even if the level of domestic car production does rebound, it will probably reach a level of only around 10.1 million units, just barely greater than production in the last fiscal year.

Depending on exchange rate levels, domestic finished car production may fall in fiscal 1996 and a genuine quantitative recovery will probably be difficult. A recovery in profits in the automobile industry spurred by an expansion in production volume will also be unlikely. Even with a halt to the rise of the yen, for example, the parts and materials manufacturers that supply the auto makers will find themselves in the difficult position of facing demands to reduce their prices. ■

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