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Topics China's automobile sales will turn around in 2019

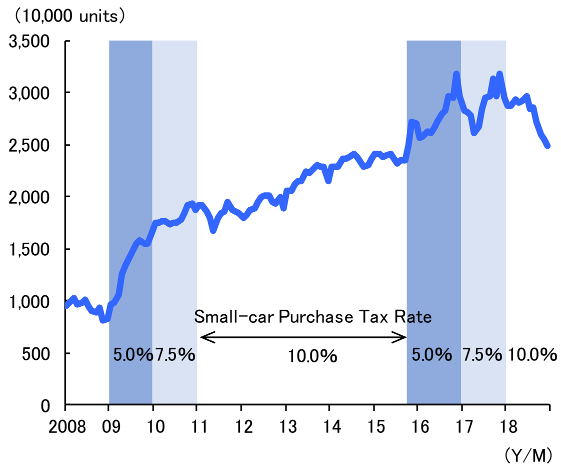
Automobile sales in China fell in 2018, but are expected to turn around in 2019. The government's measures to stimulate automobile demand, easing of the conflict between China and the United States, and a rise in incomes are likely to bring sales back on track.

■ Year-to-year decline in automobile sales for the first time in 28 years

The year 2018 was difficult for the Chinese automobile market. According to the China Association of Automobile Manufacturers (CAAM), the number of automobiles sold decreased to 28.08 million units in 2018, down 2.8% from the previous year. The industry saw sales decrease on a year-to-year basis for the first time in 28 years.

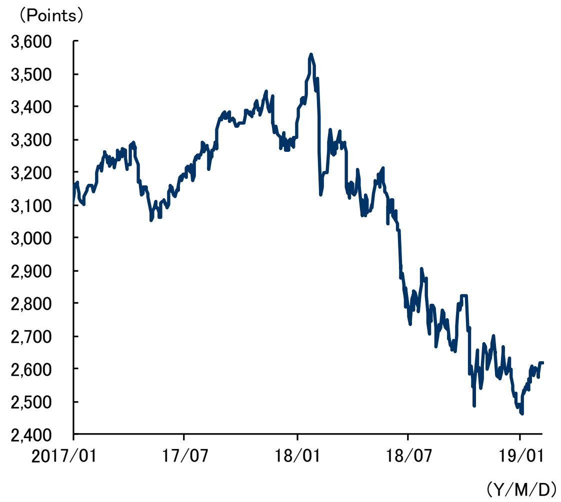
In early 2018, the number of automobiles sold declined due to the complete expiration of a tax break for those who purchase small cars. For small cars (those with engine displacement of 1.6 liters or less), the car acquisition tax rate is normally set at 10.0%. However, with the aim of shoring up the economy by stimulating automobile demand, the government lowered the tax rate to 5.0% from October 2015 to the end of 2016, and kept it at 7.5% during 2017. Consequently, the automobile sales for these two years moved above the trend line from 2011. But sales moved in opposite directions, staying below the trend line when the tax break ended in 2018. In particular, sales of China's local brand car manufacturers declined sharply, since they enjoyed greater benefits from the tax break.

＜Automobile Sales (Seasonally-adjusted Annualized Rate)＞



Source: The Japan Research Institute, Ltd., based on data from the China Association of Automobile Manufactures

＜Shanghai Stock Exchange Composite Index＞



Source: Shanghai Stock Exchange

Furthermore, in the latter half of the year, automobile sales rapidly deteriorated due to the impact of weak stock markets and customers' reluctance to purchase U.S. automobiles. The Shanghai Stock Exchange Composite Index peaked at 3,559 points on January 24, 2018, and declined to 2,494 points at the end of 2018. This occurred because the Chinese government tightened its financial regulation and supervision and also implemented measures to control the rise in real estate prices, all while trade frictions between China and the United States intensified. A 30.0% fall in the stock price index caused a negative wealth effect, depressing household purchasing power. The impact of customers delaying purchases of U.S. automobiles was also huge. When the relationship between China and Japan deteriorated in 2012, the number of Japanese automobiles sold in China was temporarily reduced to half. The number of U.S. automobiles sold decreased by 40.0% due to the current conflict between China and the United States.

■ Automobile sales will stop falling in 2019

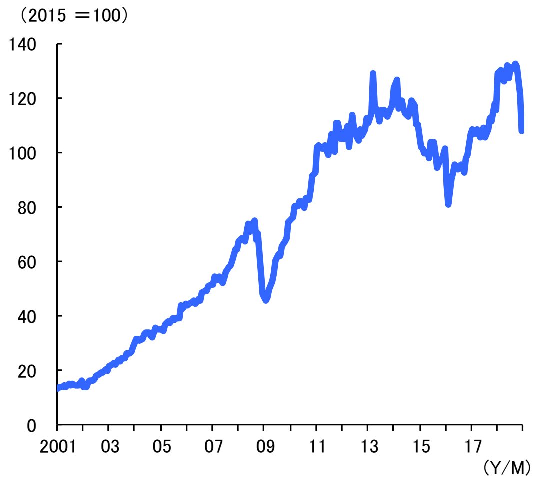
However, we forecast that the number of automobiles sold in China will stop falling and turn around soon in consideration of the three factors mentioned below.

The first factor is the government's measures to stimulate demand. The government has been strongly concerned about an economic recession. There are signs of a substantial decrease in demand. For example, total imports drastically declined in December 2018. The current economic situation is similar to that of 2008, when the financial crisis occurred following the collapse of Lehman Brothers, and that of 2015, when the China shock occurred. Although the government has implemented economic stimulus measures since the previous year, including the relaxation of credit and a reduction in personal income tax, the effects of such measures to prop up the economy have not yet become obvious. Therefore, the government is examining a measure to stimulate automobile demand, which can be expected to work immediately.

On January 29, 2019, the central government promulgated a policy package called “Improving the implementation plan of promoting the steady growth of consumption to promote the formation of a strong domestic market” and announced it will allow local governments to introduce an automobile purchase subsidy program. Although the policy package does not provide the size of subsidies, we expect that the subsidies will be an appropriate size, considering that the macro economy remains challenging. The central government is likely to give financial support to local governments to help them secure funds. At the Central Economic Work Conference held in December 2018, the Xi Jinping government already decided to drastically expand the local government bond issuance limit as its economic management policy for 2019.

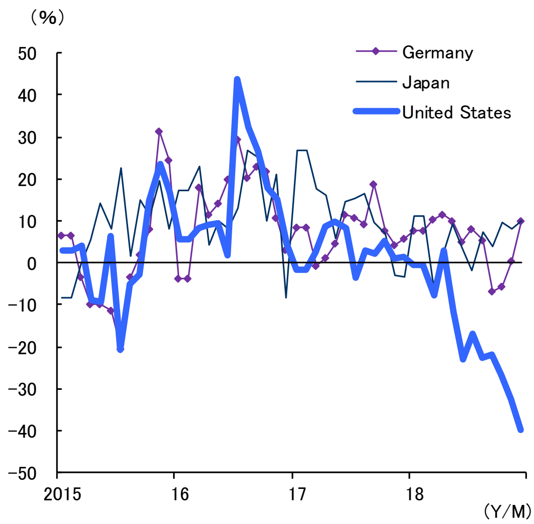
Furthermore, there is a possibility that a tax break for small cars will be introduced again. In 2009, the government simultaneously introduced subsidies for the purchase of automobiles in rural areas and for the replacement purchase of cars in urban areas as well as a tax break on small cars. We believe that the government will attach importance to measures to rev up demand for automobiles.

＜Import (Seasonally-adjusted)＞



Source: The Japan Research Institute, Ltd., based on data from the General Administration of Customs of China

＜Automobile Sales by Brand (YoY)＞



Source: The Japan Research Institute, Ltd., based on data from the China Association of Automobile Manufactures

The second factor is a temporarily easing of conflict between China and the United States. If the China-U.S. trade war intensifies further, not only domestic demand but also external demand will unavoidably be affected, which, in turn, will increase downward pressure on the economy. As the Chinese government is concerned about an economic slowdown, it has been changing its stance and has given concessions in trade negotiations with the United States to a certain extent in order to avoid an additional hike in tariffs by the United States. If an additional increase in customs duties is avoided, financial and capital markets will welcome it. Furthermore, such a decision is expected to improve the sentiment of consumers who are delaying the purchase of U.S. automobiles.

The third factor is a long-term market expansion supported by a rise in income level. In 2019, nominal income is forecast to continue growing at 8% on an annualized basis. The penetration rate of automobiles still remains at a low level in China, one unit for every seven persons, far below Japan’s level of one unit for every two persons. Although the penetration rate fluctuates depending on economic events from time to time, the rate is highly likely to go up on a slightly longer basis along with a rise in income levels.

Consequently, we have come to the conclusion that a fall in the number of automobiles sold will end at some point. With negative factors decreasing, automobile sales are expected to be back on a growth path.

(Shinichi Seki)

Korea Economy slowdown

■ Investment and exports were sluggish

In 2018, Korea's real GDP grew 2.7%, the lowest growth rate in six years, slowing down from a 3.1% growth in 2018.

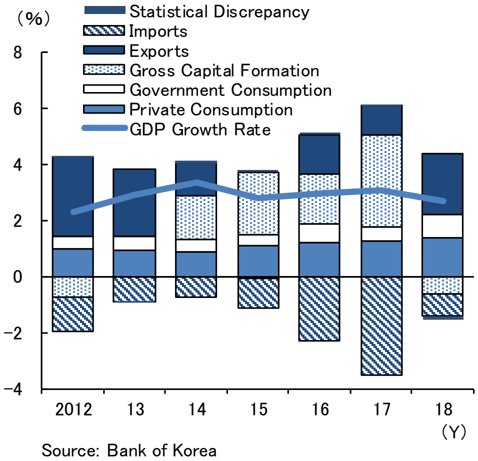
The main reason for the slowdown of the economy was a year-on-year decline in gross capital formation, which had served as an engine of the economic growth in recent years. In addition to a sharp decrease in construction investment caused by stricter regulations on housing loans to cope with overheated investment in condominiums, capital investment in machinery and facilities also declined against the backdrop of the dismal outlook for the semiconductor market and the sluggish capacity utilization rate in the manufacturing industry.

Exports posted a year-on-year growth, supported by the brisk semiconductor market in the first half of 2018. However, semiconductor demand abruptly slowed down in the latter half of the year due to a fall in demand for smartphones and the trade friction between the United States and China. Consequently, current exports of goods declined from the previous year for two consecutive months.

Although the Moon administration, which advocates income-led economic growth, implemented measures including a drastic hike in the minimum wage and an increase in pension for low income earners, private consumption was anemic and stagnated. In particular, the minimum wage hike caused adverse effects, such as downward pressure on employment because of an increase in the burden of labor costs for enterprises.

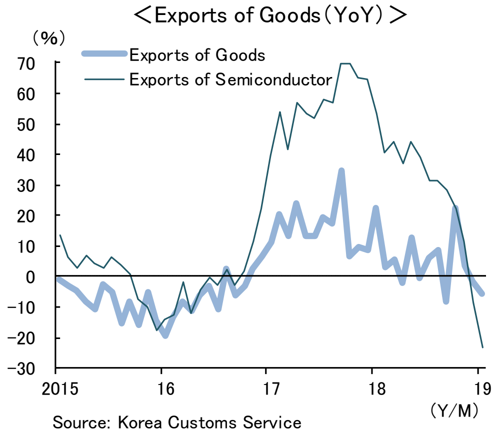
In the future outlook, the economy is likely to continue slowing down. The semiconductor market is expected to be in an adjustment phase until the first half of 2019 and the correction in condominium construction and machinery investment is likely to linger further. However, as the Moon administration places economic recovery as well as the North Korea problem as its most important challenges, it has focused all its energies on the implementation of economic stimulus measures, such as the expansion of employment by public agencies. Thus, there is a strong possibility that Korea will be able to avoid economic downturns such as a less than 2% GDP growth.

<GDP Growth Rate and Contributions by Expenditures>



Source: Bank of Korea

<Exports of Goods (YoY)>



Source: Korea Customs Service
Ministry of Trade, Industry and Energy

■ Deteriorating relationship between Japan and Korea

Recently, the relationship between Japan and Korea has been rapidly worsening because of incidents such as a judicial decision by the Supreme Court of Korea that orders Japanese companies to compensate drafted workers for their forced labor and the locking of a fire control radar on a patrol plane of Japan's Maritime Self Defense Force by a Korean Navy destroyer.

The series of incidents not only damages Korea's image in Japan but also increases the risk of investment in Korea, including the possibility of lawsuits and seizure of assets in Korea. Therefore, such incidents are very likely to put downward pressure on growth in both the number of Japanese tourists to Korea and the amount of direct investment in Korea by Japanese companies in the near future. According to data in 2018, Japan held a notable market share in Korea. For example, Japanese tourists account for 19.0% of total tourists to Korea (the second largest after China) and direct investment in Korea from Japan constitutes 5.0% of total direct investment. If the deteriorating relationship between Japan and Korea lingers on, there is a great possibility that it will put further downward pressure on a weak Korean economy.

(Michinori Naruse)

Vietnam *In 2019 the high pace growth is expected*

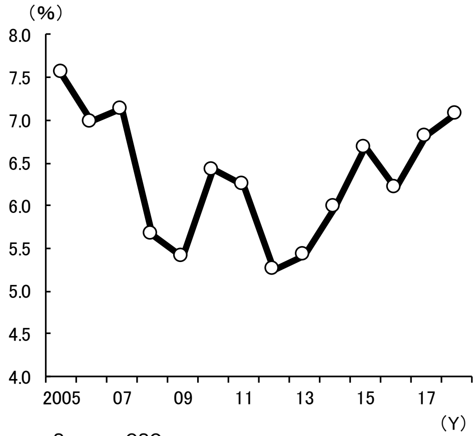
■ In 2018, the economy grew at a 7.0% level for the first time in 11 years

The growth of the Vietnamese economy accelerated in 2018. According to the General Statistics Office of Vietnam, Vietnam's GDP grew at 7.1% for a full year in 2018. The growth rate exceeded the 7.0% level for the first time since 2007. This is the highest growth among ASEAN5 countries (Indonesia, Malaysia, Philippines, Thailand, and Vietnam).

Looking closely at the breakdown by the demand item, robust domestic demand pushed up the growth rate. First of all, despite sluggish automobile sales due to the establishment of non-tariff barriers on import cars, private consumption was steady, supported by solid growth in other fields. Retail and service sales in real terms maintained higher growth throughout the year. This was because while the inflation rate remained at a relatively lower level, the income environment improved, such as a rise in the minimum wage, contributing to solid consumption.

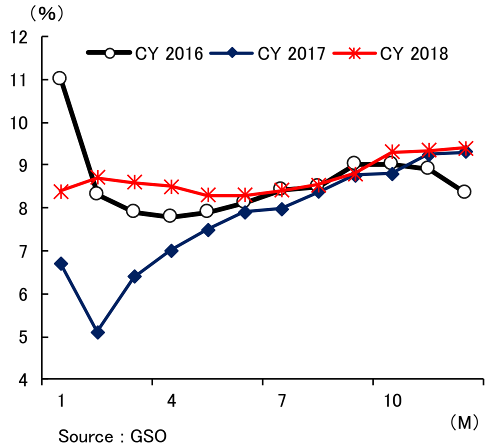
In addition, investment, as a whole, was also solid. The construction sector saw the accelerate growth to 9.2% on a year-on-year basis. Although public investment decelerated because of the government's fiscal austerity policy, private investment and direct investment by foreign enterprises shored up the overall investments. Meanwhile, a slowdown in external demand was inevitable. The decrease was mainly due to an eventual backlash from a sharp increase in the previous year. However, as demand for smartphones was sluggish around the world toward the end of 2018, shipments of cellular phones and their components stagnated.

＜Real GDP Growth Rate＞



Source : GSO

＜Real Retail and Service Sales (Y o Y)＞



Source : GSO
Note : The number is year to date.

■ Growth is likely to slow down slightly in 2019

Looking at the future, Vietnam's GDP growth rate is forecast to decelerate. As the global sales slump caused by a slowdown in the Chinese economy and the saturation of smartphones is likely to continue, the production and export of mainstay cellular phones and their components is estimated to decrease. In January 2019, the export of cellular phones and their components already plunged by 28.0% from the previous year. However, considering a structural expansion of private consumption against the backdrop of a rise in the middle class, the progress of infrastructure development and a transfer of production facilities from China to Vietnam triggered by the trade friction between the United States and China, a drastic decline in the growth rate is unlikely to occur. In 2019, we forecast that the Vietnamese economy will maintain higher growth, in the higher 6.0% range.

However, it is also necessary to pay attention to the risk of an unexpected fall in the growth rate. After entering 2019, concerns over a business downturn have risen mainly in Europe and the United Sates. As Europe and the United States are the largest destination of clothes and shoes manufactured in Vietnam, economic deterioration in western countries will lead to a sharp drop in Vietnam's export to these countries. If the business performance of exporting companies deteriorates, the subsequent worsening of the employment and income environment will weigh on private consumption. Furthermore, as Vietnam's public debt outstanding is close to its ceiling determined by the law, the country has little room for fiscal stimulus to revive its economy when the growth rate declines. When the country experiences a sharp fall in GDP growth rate, Prime Minister Phuc will face a tough job of steering the country, being torn between economic growth and financial discipline.

(Yuta Tsukada)

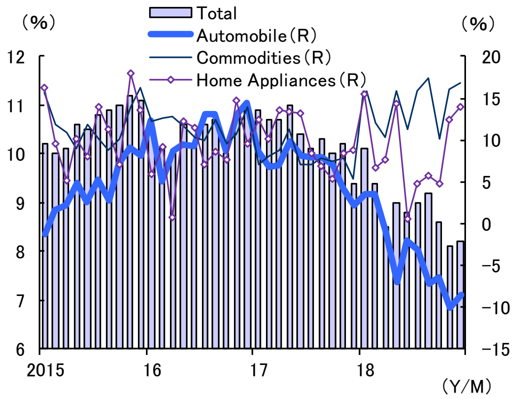
China Revealed consumption stimulus measures

■ Measures to stimulate consumption announced

As the manufacturing PMI (Purchasing Managers' Index) in January 2019 fell below 50 for two consecutive months, the slowdown of the Chinese economy has become apparent. In such a situation, the Chinese government has further concentrated on boosting household consumption.

At the end of January 2019, the central government announced a "consumption expansion plan." The plan aims to push up consumption, which can be immediately effective in supporting the economy, through the expansion of measures to encourage people to purchase automobiles and home appliances. The plan includes the below mentioned measures to inject impetus to automobile sales that are the main contributor to weaker consumption growth: offering of a subsidy for those who replace cars, implementation of a tax break for dealers of used cars, and easing of limits on the purchase of cars. Meanwhile, to expand sales of home appliances, the government announced a policy to offer a subsidy for those who replace a) eight items including refrigerators, washing machines, air conditioners, and personal computers, and b) for those who purchase energy-saving and smart home appliances. The plan also includes investment for making apartments barrier-free and developing facilities for child and elderly care services.

＜Retail Sales (Nominal, Y o Y)＞



Source: National Bureau of Statistics
Note: Every year, from March to December.

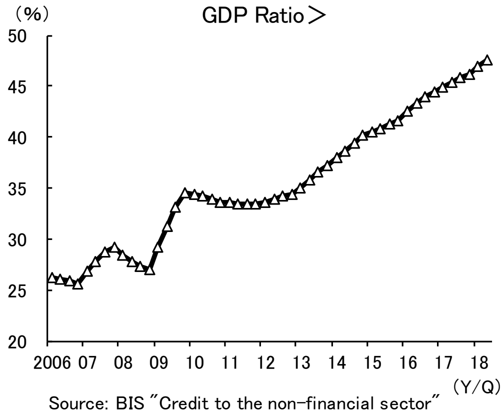
What lies behind the economic stimulus packages that aim to boost household consumption is the transformation of the economic structure in China. The real GDP growth rate through the year of 2018 was 6.6%. Household consumption contributed to most of the GDP growth (5.0% percentage points) and was the key growth driver in place of investment. Furthermore, the ratio of household consumption to GDP has been on the rise after hitting a bottom in 2010. While the influence of household consumption on the entire economy has been increasing, the growth rate of the total retail sales of consumer goods have been declining due to a slump in consumer sentiment. Therefore, the government aimed to shore up China's economic recovery by cultivating potential consumption demand.

■ Feared side effects

Looking at the future, consumer sentiment is expected to recover on a short-term basis, since the government incorporated measures with immediate effectiveness on the economy in the stimulus packages. On the other hand, attention should be paid to side effects of the consumption stimulus measures.

Firstly, the packages will result in front loading demand. If the government stimulates demand for consumer goods, particularly durable consumer goods that are not frequently purchased such as automobiles and home appliances, it is highly likely that there will be a huge negative repercussion after the end of the stimulus packages.

＜China's General Government Debt-to-GDP Ratio＞



Source: BIS "Credit to the non-financial sector"

In addition, there is concern that budget pressure will increase. Although its financial position is healthy compared to other countries, China's general government debt-to-GDP ratio has been rising. The offering of a subsidy and implementation of a tax break included in the consumption stimulus packages will bloat China's fiscal deficit further. This means that the government will have little room to use fiscal policy in the future and find it more difficult to control public debt. Considering these side effects, we believe that the Chinese government should place emphasis on the relaxation of regulations that stir up service consumption as its consumption stimulus measure instead of extravagant fiscal expenditures.

(Junya Sano)