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Topics  China’s consumers want better cars

China’s consumer sentiment is shifting from cheap cars to vehicles that more functional, stylish and comfortable. As a growing number of consumers have come to appreciate the value of Japanese cars, Japanese car manufacturers need to place more importance on the Chinese market.

■ Consumer needs becoming more sophisticated and diverse

According to the China Association of Automobile Manufacturers, automobile sales in 2014 were 23.49 million vehicles, up 6.9% on the previous year. These figures break down into 19.7 million passenger cars, up 9.9%, similarly, and 3.79 million commercial vehicles, down 6.5%. In terms of passenger cars, basic models (sedans, minivans) sold 12.38 million vehicles, up 3.1%, SUVs 4.08 million vehicles, up 36.4%, and MPVs 1.91 million, up 46.8%, while crossover models (light wagon box models and others) sold 1.33 million vehicles, down 18.1% compared to the previous year.

In recent times attention has been paid to the increasing sophistication of the demand structure in China’s automobile market. While new demand still accounts for the majority share, replacement purchases are growing steadily. As there are no official statistics on replacement purchases, the following calculations break down automobile demand into new and replacement purchases, estimating the volume for each. Normally, a certain part of the automobile stock is discarded and replaced after its useful service life has expired. Here, for the sake of simplicity, it has been assumed that the number of discarded vehicles equals the number of replacement purchases, and this is used to define replacement demand. Based on this assumption, an estimated breakdown of the 21.98 million vehicles sold in 2013 shows that the number of automobiles owned increased by 17.50 million vehicles from 109.33 million vehicles in 2012 to 126.83 million in 2013. If this portion is taken to represent new demand, then the remaining 4.48 million vehicles may be taken to represent replacement purchases. Similarly, estimating replacement demand year by year, it can be confirmed that the replacement ratio has grown from 13.4% in 2009 to 20.4% in 2013.

This growth in the number of people purchasing replacement vehicles indicates that consumer sentiment is shifting from cheap cars to ‘better cars’, vehicles that more strongly exhibit innate selling power.

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Source: The Japan Research Institute, Ltd, based on Toyota Jidosha Hanbai, ed., Sekai e no ayumi [Steps Toward the World], 1980
points, such as performance. Generally speaking, replacement purchase customers have longer experience in car ownership, and place greater importance on performance and other features. According to a survey conducted by Toyota, first time car buyers tend to prioritize economy and purchase price. Whereas the more experience a buyer has of replacement purchase, the lower the priority of economy and purchase price, and the higher the priority of performance, style and comfort.

In China, changing consumer tastes are reflected clearly in the most popular vehicle choices. As stated above, sales figures for 2014 show rapid increases in SUVs and MPVs sales. Average prices of SUVs and MPVs are higher than those of sedans. However, since they carry more passengers and can take more luggage, their full benefit can be leveraged not only on weekday commuting and shopping but also especially on holidays and family trips. In industrialized nations, as the automobile ownership ratio increased, the SUV and MPV share also grew, and the same kind of sophistication and diversification in the demand structure is now being seen in the Chinese market.

While these changing trends may represent a challenge for local manufacturers, whose strengths lie in low prices, they may represent an opportunity for Japanese and other manufacturers, whose strengths are in the level of quality and after sales service that they can provide. Nevertheless, in addition to the lack of promotion activities and sales networks, etc., the cooling of Japan – China relations has had a dilatory effect, and Japan’s share of the passenger car market in 2014 dipped 0.6% points from the 15.7% posted in the previous year.

Future outlook and challenges

Looking ahead, it is expected that the demand structure will become ever more sophisticated and diverse. In 2013, the car ownership ratio was one out of every 11 persons. This was well below Japan’s one out of two. In the years ahead, as income levels rise, there is a strong probability that China’s car ownership ratio will rise even further. Accordingly, it is thought that the replacement demand will increase, and that the replacement purchase ratio will grow further.

Given this premise, until when, and to what extent, can the replacement purchase population, with its preference for performance, style and comfort, be expected to expand? If it is estimated that China’s car ownership rate will increase to one car for every five persons by 2010, to one for every three by 2030, and one for every two by 2040, then replacement demand may be expected to increase to 120 million vehicles, 210 million, and 290 million, respectively. In contrast, it is thought that the population of those purchasing automobiles for the first time will increase at a slower pace, changing to a decline around 2020. There is a very strong likelihood that the demand for low priced entry models will become saturated and will gradually taper off.

Examination of Japanese manufacturers’ overseas business expansion shows that, until now, Europe and the US have been the main markets. While inroads have been made into the Chinese market, Japanese manufacturers have a large market share in Southeast Asia, and that is where their emphasis seems to lie. This may be said to have been the right move, given that, in addition to the significant involvement of the Chinese government, while the population of purchasers prioritizing economy and low price grew at a rapid pace, the population preferring quality and after sales service grew at a very modest pace.

However, in recent years, consumer preference in China has been shifting from cheap cars to ‘better cars’, with an emphasis on such features as performance and the like. If, indeed, there is to be a future increase in the number of consumers that appreciate the value of Japanese automobiles in this way, then perhaps it is time for Japanese manufacturers to reconsider the importance of the Chinese market.

(Shinichi Seki)
Korea  Domestic and foreign demand lacking strength

■ 3.3% growth in 2014

South Korea’s real GDP growth rate in 2014 was 3.3% year on year, slightly up on the previous year (3%), but the growth rate has been slowing recently, posting a wafer thin 0.4% quarter on quarter growth in October to December, down from 0.9%, similarly, in the previous quarter.

In terms of the contributions of individual demand items, private consumption was 0.2% points, government consumption 0.1% points, gross capital formation minus 0.1% points, and net exports 0.2% points. Net export growth was held back by a lack of strength in domestic consumption growth, in particular a massive minus 9.2% drop in construction investment.

Completed construction work totals (October to December quarter, seasonally-adjusted figures) for the public sector and private sector both showed negative growth, down 8.0% and 3.5%, respectively, with a particularly significant slump in the public sector. Part of the background to this is said to be that falling tax revenues in the wake of economic stagnation have prompted the government to cut back on public works.

On the other hand, there are signs of a recovery in domestic consumption. December’s retail sales index was up 4.4% compared to the same period in the previous year. In terms of individual items, automobiles and other durable consumer goods grew a massive 13.9% driving consumption growth (although temporary increases in automobile sales due to model changes did have an effect). The consumer confidence index (for January), an indication of how consumers are feeling about the future performance of the economy, stood at 102, recovering for the first time in four months.

As for foreign demand, January’s exports (customs cleared basis) grew minus 0.4%, falling below the previous year’s level. In terms of individual items, while semiconductors (13.7%) and general machinery (6.9%) performed solidly, the sharp drop in crude oil prices caused growth in petroleum products (minus 38.5%) and petrochemical products (minus 19.8%) to contract massively, and negative growth among other main export items, such as telecommunications equipment (minus 1.9%), iron and steel (minus 2.4%) and automobiles (minus 4.1%), hindered growth overall. While semiconductors and some other items performed well, export growth overall continues to lack strength.

In response to the recent economic deceleration, Bank of Korea has revised its economic growth forecast for 2015 down from 3.9% (as of October, 2014) to 3.4% (first half 3.0%, second half 3.7%).

■ Park administration losing influence

President Park’s approval rating is falling quickly. According to a survey by a Korean survey company, President Park’s approval rating plummeted from 40% to 29% in weeks one to four in January. The delay in economic recovery, growing criticism of the President’s political management, and confusion over tax reform, are among those cited as contributory factors. In December, the government launched its ’2015 Economic Policy Plan’, which calls for greater efficiency in the public sector and the vitalization of the financial sector, expansionary fiscal policy and the growth of domestic demand through improved incomes, and so on. The challenge for President Park will be whether she can steadily implement these important policies and lead the Korean economy to recovery, while she struggles to retain her political influence.

(Hideo Oshima)
Malaysia  Growing downward pressure on the economy

■ Falling prices of primary products holding down export growth
Since the middle of 2014, Malaysia has seen export growth, till now the driver of its economy, continue to lose momentum, while healthy domestic demand has taken over the role of supporting the economy. In spite of the fact that the blunted pace of export growth caused external demand to become a negative contributor, a quickening of the pace of growth in consumption and total fixed capital formation meant that Malaysia’s real GDP growth in the October to December quarter, 2014, accelerated by a small margin on the previous quarter (5.6%) to post 5.8%, compared to the same period in the previous year.

Nevertheless, as a result of the effects of the falling prices of crude oil and other primary products, the downward pressure on the economy has begun to increase. The plummeting international price of crude oil has not only depressed exports, of which crude oil and petroleum products account for over 10%, the price of natural gas, which like crude oil accounts for about 10% of exports, is linked to that of crude oil and indirectly exerts downward pressure on export prices. For this reason, these items have significant weight, and nominal exports to Japan, Korea and Indonesia are expected to continue to struggle for the foreseeable future. Further, the price of palm oil as well, which boasts a share of around 5%, is stagnating against the backdrop of over-production in various countries of Asia, and this will likely continue to contribute to downward pressure on the growth of exports to India, Vietnam and China.

■ Supplementary budget announced
The falling prices of primary products will not only exert downward pressure on the economy through shrinking exports, but will also have the effect of enlarging the fiscal deficit through a reduction in tax revenues and dividend payments and the like from natural resource related companies, which account for about 30% of tax revenues. Currently, Malaysia’s outstanding public debt total ratio against nominal GDP is close to the government’s target ceiling of 55%, and in order to avert any further expansion in the fiscal deficit, the government announced a supplementary budget for fiscal 2015 (January to December, 2015) in late January, 2015. The supplementary budget keeps development expenditure for projects like transportation and energy infrastructure development and the like unchanged, but reduces general expenditure from the original plan. As a result, the fiscal deficit against nominal GDP for that year, at minus 3.2%, is slightly larger than that of the original budget (minus 3.0%), but it does call for a contraction in comparison with last year (minus 4.0%).

In addition, the flood damage caused by record breaking rainfall levels experienced along the east coast of the Malay Peninsula between the latter half of December, 2014, and January, 2015, is believed likely to have a downward impact on the economy in the January to March quarter. While it is expected that a significant deterioration in the economic situation can be avoided, as consumption performs strongly against the backdrop of a healthy employment environment, the forecast is that downside risk will continue to be a factor for the time being.

(Shotaro Kumagai)
Philippines  Economy improved in October to December quarter

Economic growth for whole year 2014 fails to meet government target

The Philippines’ real GDP growth rate for the October to December quarter, 2014, was 6.9%, compared to the same period in the previous year, improving on the July to September quarter (5.3%). However, the economic growth rate for the whole year 2014 was 6.1%, falling below the results for 2013 (7.2%) and the government’s target for 2014 (6.5% to 7.5%).

The contribution rates for demand items in the October to December quarter were 3.7% points for private consumption (3.4% points in July to September), 0.8% points for government consumption (-0.3% points, similarly), 1.8% points for gross fixed capital formation (2.2% points), 5.5% points for exports (5.3% points), and -2.3% points for imports (-2.8% points). While private consumption and exports continued to grow strongly, government expenditure’s positive growth boosted economic growth.

Private consumption performed strongly, due to the fact that remittances of money sent home by Overseas Filipino Workers continued at a strong pace, and consumer prices have peaked since last fall. Also, real exports of electronic parts and components, a major export item for the Philippines, were up 25.4% compared to the same period in the previous year, and this drove export growth overall. In terms of government consumption, in spite of the fact that, in response to the Supreme Court decision that the Disbursement Acceleration Program (DAP) was unconstitutional, the government was very cautious about budget implementation in the July to September quarter, so that expenditure fell below the previous year’s level, spending growth recovered in the October to December quarter in the run up to Pope Francis’ visit to the Philippines in January, 2015, and in order to accelerate recovery from the damage incurred through the Yolanda typhoon. In addition, as a result of this, construction investment increased, posting 21.9% growth in the October to December quarter, a significant increase from the July to September quarter (13.2%).

In terms of the future outlook, while it is expected that the Philippines’ economic growth rate in 2015 will accelerate into the mid 6% range, boosted by remittances sent home by Overseas Filipino Workers, abroad and healthy growth in exports as the US economy recovers, and progress in the government’s infrastructure development plans, among others, nevertheless, it looks as if it will be difficult to achieve the government’s growth target (7.0 to 8.0%).

Inflation rate dips to a 17 month low

As the economy switched to recovery, the inflation rate started to decline after peaking at 4.9% in August, 2014, and dropped to 2.4% in January, 2015, its lowest level in 17 months. Part of the background to this has been the fall in the prices of various kinds of natural resources and product prices since the summer of 2014. The Philippines’ consumer price index, in addition to being highly sensitive to the prices of food items, which account for around 40% of the component item weight, has a structure that is easily swayed by international commodity markets and exchange rate trends, due to the country’s high level of dependence on imports of food and energy.

Although the central bank of the Philippines raised its policy interest rate in July and September of last year in response to the rise in the inflation rate over the summer, the inflation rate has come down of late, and the possibility of further rate hikes has receded. Nevertheless, there are expectations that US interest rates will begin to rise after the middle of 2015, and given the risk that the peso’s depreciation may trigger another rise in the inflation rate, it looks likely that the central bank will maintain its tighter monetary stance for the foreseeable future.

(Yuta Tsukada)
China  Foreign direct investment coming into balance

■ Wafer thin increase in direct investment in China in 2014

According to the Ministry of Commerce, inward direct investment in China in 2014 was worth $119.6 billion. This was the largest amount recorded so far, but the growth rate was only 1.7% more than in the previous year, and has held more or less steady since 2011.

One of the main reasons behind the failure of the growth rate to grow is that, in addition to the fact that direct investment in the manufacturing industry has been falling, year on year, for three consecutive years, the pace of contraction (minus 12.3% compared to the previous year) has been increasing. This seems to be due to the fact that, as personnel and other costs rise and the yuan strengthens, China’s position of advantage as a production base for export items has deteriorated. As a result, investment in the manufacturing industry, which accounted for around 70% of direct investment in China in 2004, shrank to 33.4% in 2014. On the other hand, the service sector managed to maintain an expansion trend in many industry categories, and this boosted investment growth overall.

In contrast, outward direct investment in 2014 grew 7.6% on the previous year, at $116 billion. It should be noted that, whereas the inward direct investment figure released by the Department of Commerce does not include investments in banking, insurance or securities, outward direct investment does include investments in finance. However, the significant increase in outward direct investment may be said to indicate that FDI (foreign direct investment), which had hitherto been in a strong inflow mode, has now entered a more balanced phase.

Also, according to the ‘2013 Statistical Bulletin of China's Outward Foreign Direct Investment’, it was identified in 2013 that government owned enterprises’ share as a source of investment (excluding finance) had fallen to the 40% range, while non-government enterprises’ share was tended to grow. While a clear conclusion cannot be reached, as details have not yet been released, there is a strong possibility that not only state owned enterprises but also private sector enterprises have engaged in aggressive direct investment overseas.

■ Outward direct investment set to exceed inward direct investment in 2015

Looking forward to FDI in 2015, in the case of inward direct investment, it is difficult to expect any sudden acceleration in the pace of growth. As it becomes more and more difficult to secure personnel, wages and salaries continue to rise, and this is one factor that will likely blunt the pace of growth in direct investment from abroad. Further, although People’s Bank of China has recently been working to leverage the economy, for example announcing on February 4 that the deposit reserve for all financial institutions would be lowered for the first time in two years and nine months (effective February 5), it will likely still take some time before foreign investors’ concerns over the future of the Chinese economy can be assuaged.

Meanwhile, more than just adjusting to increased production costs, it is expected that that Chinese companies’ investments will become energized as they seek to acquire foreign brands and technological expertise. The government also has repeatedly voiced its stance of supporting Chinese companies’ investments overseas. These developments taken together, it is becoming more and more likely that outward direct investment in 2015 will exceed inward direct investment. In the light of that set of circumstances, it will be important to pay careful attention to China’s FDI and related policies.

(Junya Sano)