Analyst Note>

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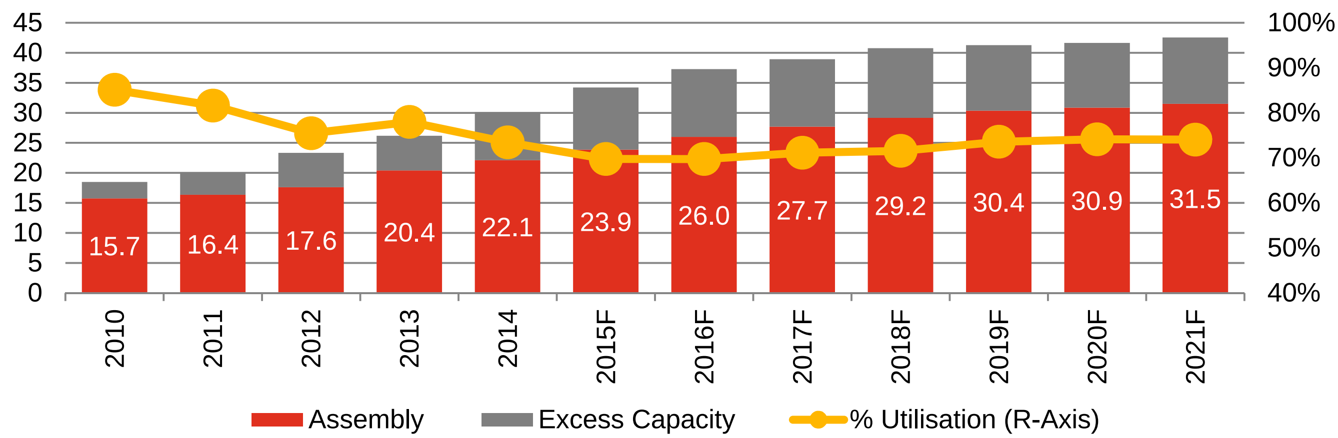
China: Coming down to earth

Economic turbulence has China decelerating

After a decade of robust and record-setting growth, the automotive market in China is slipping thanks to a mix of macro-economic troubles as well as the growing pains related to the market's maturation. As bad news continues to dominate the conversation, what's the outlook on the sector going forward?

Light Vehicle Assembly
2010 – 2021 (millions)



Source: Autofacts 2015 Q3 Forecast Release

Sagging, sluggish sales

Against the backdrop of currency woes, economic uncertainty, and government curtailment of vehicle ownership as cities struggle against pollution and traffic congestion, the world's largest automotive market is now slowing down. Through the first half of the year, the market has registered 7% in light vehicle sales growth, reaching 11.2 million units. Though growth in and of itself is encouraging, the number is tempered by only slight growth of 2.3% in May and a contraction of -3.4% in June, which marked the lowest tally in sixteen months. Preliminary figures for July suggest a second consecutive month of decline reaching -6.6% year-over-year. The continued slide in sales is triggering concern across the sector given that most automakers have already slashed prices in the face of bloated inventory levels.

On shaky ground

Though automakers and analysts alike have forecasted more realistic, tapered growth for China in the long term, the current slow-down has transpired more quickly than anticipated. Recent developments in the greater macro-economic climate in China have coincided with a deceleration within the automotive sector, and the market faces a shaky short term outlook. The devaluation of the renminbi can be seen as an attempt to jumpstart exports with the cheaper prices – and perhaps a direct output of the growing concerns over the domestic economy. Meanwhile, the volatile domestic stock markets have fallen by more than 30% in the two-month period between June and July, which equates to a loss of roughly $3.4 trillion in financial assets.

The economic developments as of late have been particularly problematic for foreign joint ventures. The weaker renminbi makes imported vehicles more costly, and even domestic brands have employed price cuts in hopes of moving inventory. Additionally, the shift towards equity investments has diverted disposable income into the stock market that could have otherwise been used to purchase new cars. With the stock market collapse and a shaky consumer outlook, big-ticket purchases like vehicles will likely be tabled indefinitely.

All in the (segment) mix

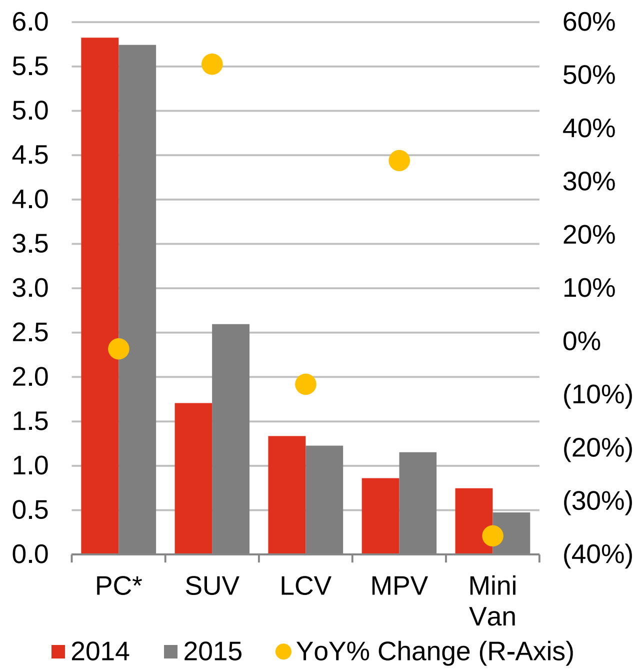
Though negative economic currently dominates the headlines in China, it's not all doom and gloom for the world's largest and fastest growing market. Yes, the automotive sector as a whole has declined for two months, but underneath this topline is a mixed bag when it comes to segment performance. Minivans and cars continue to struggle, dropping by 40% and 1.4% respectively through the first half of the year. On the other end of the spectrum, SUVs and MPVs continue gaining momentum, with SUV sales improving by 52% year-over-year to reach 2.6 million units through June, and MPVs jumping 34% to 1.2 million units sold. Domestic brands have unveiled a slew of new, less expensive utility vehicles to meet consumer preferences while joint ventures are now scrambling to follow suit. With sales growth slowing and market share battles becoming increasingly competitive, it will be more important than ever for automakers to optimize their product portfolios in terms of size and segment offerings. It should be noted though, that the auto sector was already on track to slow down, with double-digit growth rates declining as the market continues to mature and vehicle parc within large cities become saturated. While the macroeconomic developments exacerbate the contraction in auto, they were not the triggering events for the current contraction.

Growing pains

There's little doubt that the current backdrop in China is cause for concern, but the long term potential remains, even amidst tempered economic growth overall. Income amongst the middle class continues to grow, and consumer tastes will likely shift to larger, higher-value luxury purchases. Further, the vehicle parc for the entire market remains around 100 vehicles per 1000 citizens, well behind the global average of 200 vehicles, let alone the rates of 600 and 800 in Japan and the US respectively. With ample room left for long term growth, the Autofacts forecast calls for a restrained market result of ~7.9% for 2015, and a moderate compounded annual growth rate (CAGR) of 4.4% throughout the forecast window to reach 31.5 million by 2021. Going forward, focus will need to shift towards the country's interior cities to support long-term growth. If automakers can do this while striking the right balance of products within their portfolios and closely aligning supply with demand, they can likely weather the storm and retain a stake within the most lucrative market in the auto sector.

Sales by Vehicle Type

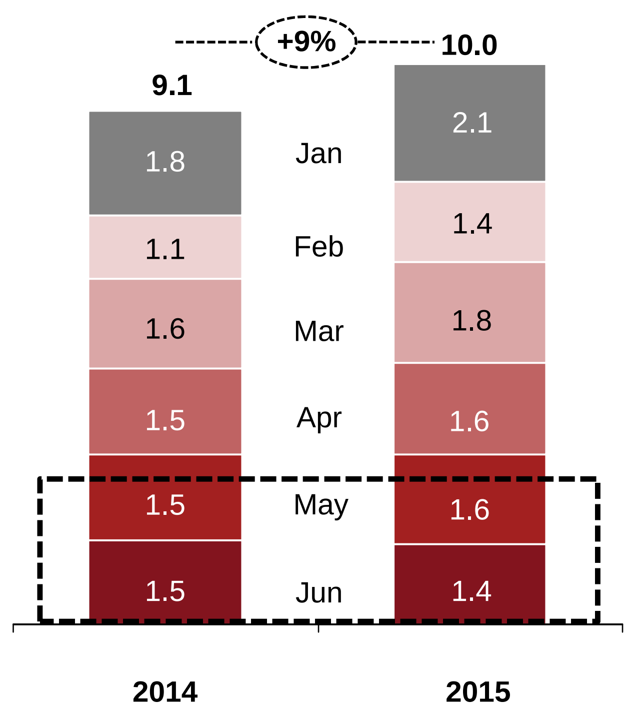
2014 vs. 2015 YTD (millions, June)



Source: China Business Update, Autofacts Analysis *PC = Passenger car

YTD Sales (through June)

2014 vs. 2015 (millions)



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