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Talking point

China's car market on the road to normality – lasting increase in price pressure

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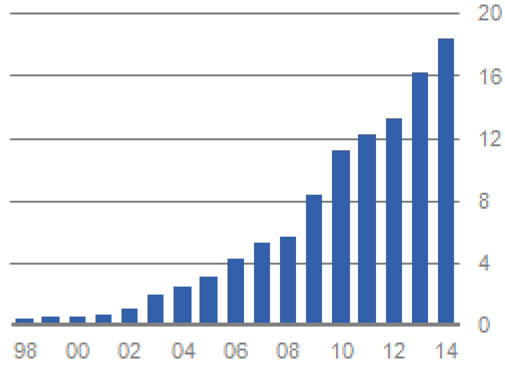
Between 2000 and 2014, unit passenger car sales grew by 27.5% in China on average – per year. However, for the past several months there have been signs of the dynamic growth petering out; from May to July 2015 sales were in fact down 1.3% on the corresponding year-earlier level. The average growth of car demand in China is poised to plummet to a single-digit rate in the next few years. This is a step towards "normality". The anticipated slower growth in demand for passenger cars – coupled with growing production capacities in China for the time being – are likely to lead to further intensifying price and competitive pressures in the Chinese market. German makers of premium-segment cars will be unable to escape completely unscathed from the impact of such a trend.

The Chinese car market registered huge growth in recent years. Unit passenger car sales increased by an average of 27.5% – per year! – between 2000 and 2014. Car sales in China have surpassed US levels since 2013, so China has advanced to become the world's biggest car market in the meantime. There was not a single year in which sales declined during this entire period. This is striking insofar as car demand in all the other large emerging markets (e.g. India, Brazil, Russia and the members of ASEAN) fell at times in the course of the past 15 to 20 years – in some cases plunging noticeably, in fact. Highly volatile growth rates including temporary declines in unit passenger car sales are very typical of "young" car markets. Therefore, China is the exception among the emerging markets with its steady expansion.

Steady growth to date

Passenger car sales in China, million units



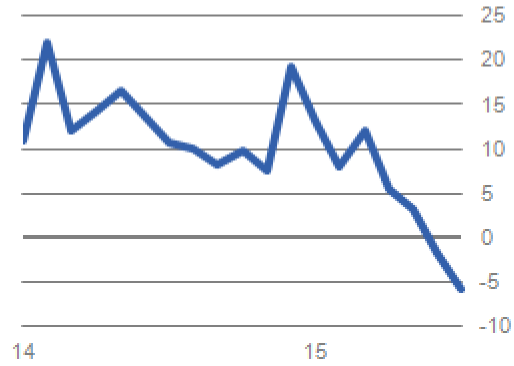
* As defined in the VDA statistics

Source: VDA

For the past several months, however, there have been signs of the dynamic growth in the Chinese car market petering out; from May to July 2015 passenger car sales (as defined statistically by the German Association of the Automotive Industry (VDA)) were in fact down 1.3% on the corresponding year-earlier level. There are several main reasons for the lower growth rates. For example, the overall economic momentum in China has slowed of late. The recent turmoil in the Chinese financial markets also plays a part. A certain basis effect is a further factor. After all, the strong growth of the past few decades means that the sales level is now so high that continued double-digit growth rates would translate into ever climbing absolute car sales. This becomes more difficult from year to year, though. In the end it is replacement purchases that are gaining importance in the Chinese car market.

Temporary declines in car sales have already been observed in certain Chinese cities and/or regions over the past few years. These were due to, among other things, regulatory requirements such as time-limited registration restrictions. Their objective was to help fight local environmental pollution. Government policy makers will quite probably continue to resort to such measures in individual cities/regions in future. This situation is exacerbated by infrastructure bottlenecks above all in the metropolises of the coastal regions in which car density (i.e. the ratio of cars to population) is already high. These bottlenecks hamper car use in everyday life, a fact which may negatively impact car demand in the longer run.

Taken together, the outlined factors suggest that the average growth of car demand in China is poised to plummet to a single-digit rate in the years ahead. If there were to be a confluence of several negative factors from the economic and policy/regulatory environments, car demand in the total market could conceivably even decline in certain years up until 2020. Ultimately, though, the anticipated slower growth "merely" means that China's car market should gradually be moving on the road to normality.



Higher growth potential apart from the coastal regions

Nearly all market watchers expect to see a relatively noticeable shift in the growth of car demand in China in the next few years – away from the coastal regions towards the hinterland provinces where there is still a much lower level of motorisation. Since the infrastructure there is less well developed and per capita income is lower than in the coastal regions, "robust" vehicles from the volume segment will probably be in particularly strong demand there. Nonetheless, there is still sizeable sales potential for premium-segment vehicles also in these regions.

The anticipated slower growth in demand for passenger cars – coupled with growing production capacities in China for the time being – are likely to lead to further intensifying price and competitive pressures in the Chinese market in the years to come. German makers of premium-segment cars will be unable to escape completely unscathed from the impact of this trend. In this respect China is likely to temporarily lose part of its outstanding importance as a money-spinner for the German carmakers; of course, this also depends on the respective model range of the individual makers. The expected cutbacks on the income side will be more painful for the companies in the short term than potential sales declines and/or slower growth. The recent devaluation of the Chinese currency is also a cause for concern in this context because it will boost the price of imported vehicles in China, which in turn could necessitate price adjustments to the downside. The exchange rate effect should, however, be at least partly cushioned by the large share of local production.

Higher price pressure in the Chinese car market would be a further step on the road to normality, since the established car markets have been hotly contested for many years. In the short run, carmakers will probably have to respond with reduced production volumes in China in order to avoid excessive inventories. If the recent sales slowdown should persist, some plans to expand capacities could be shelved. On a medium-term horizon car exports from China to other emerging markets are likely to develop into a safety valve that eases the pressure on the local car factories.

All in all, China should remain the most important car market in the world over the next few years (in terms of unit sales), a market that – despite the current weak phase – promises continued growth. However, the growth momentum of the past 15 years is no longer in reach. At the same time, we expect the price and competitive pressures to intensify, which is why the average profit per vehicle sold is likely to decline for the time being.

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