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## Auto importers shine in the land of the rising yen

By: Dr Michael Wynn-Williams, Monday, November 08, 2010, AutomotiveWorld.com

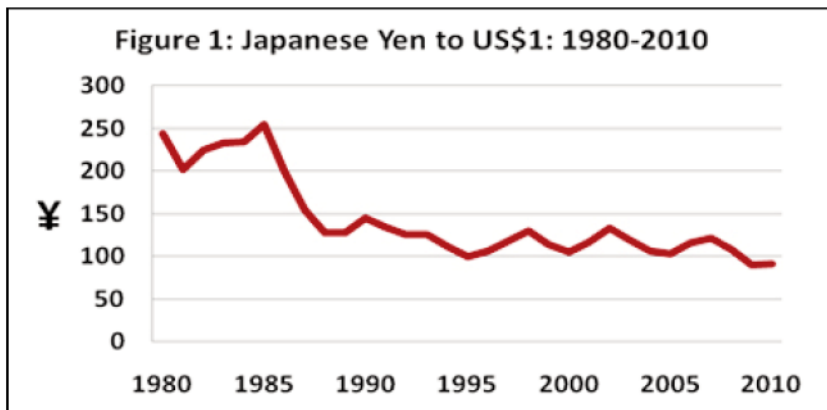
Japan's automotive trade with the rest of the world, which has so far been little more than one-way traffic, has lately experienced a small reversal in flow. The import sector in the country has shown some impressive degrees of expansion after years of decline. Is this a sign that Japan's domestic market may at last be ready to add a little foreign flavour, or is it just an import bubble?

### Japan's import sector

Japan's import sector has never been notably vibrant. Famously, government tariffs sought to protect the infant industry during the early post-war years by pricing imports out of the market. Market liberalisation in 1965 prised open enough market space for 10,000 foreign cars, climbing to 60,000 cars in 1979. According to economic theory, as the Japanese economy grew its currency should have risen in value, thereby handing a price advantage to vehicle importers. The Japanese yen, though, has long defied this logic.

The 1979 oil crisis pulled the rug from under the Japanese currency, putting imports under severe price pressure. Since then, the currency has remained stubbornly low, particularly when the mismanagement of the bursting of the bubble economy resulted in chronically low interest rates. A carry trade of Japanese funds seeking higher rates of interest overseas meant that the value of the yen was held artificially low.

Figure 1 shows Bank of Japan data on how the value of the yen was relatively stable against the dollar over a nineteen year period, from 1988 to 2007.



Since then, and particularly during 2010, the yen has gained considerable strength against the world's major currencies. This is not, though, a vote of confidence in the Japanese economy, but an indication of the poor regard held for the rest of the world's leading economies. Both the United States and the Eurozone seem hobbled by their economic problems, which then find expression in the low esteem of their respective currencies.

This has created an opportunity for importers of cars into Japan. We should ignore the so-called "reverse imports", cars that are brought in by Japanese manufacturers from their overseas plants. These are strategic imports, fed directly into the established sales channels to supplement domestic supply. Nissan found enough success importing the Dualis/Qashqai from the UK that in the end it had to commence assembly in Japan for the home market. However, reverse import volumes fluctuate according to global production schedules, not because of consumer demand for imports per se.

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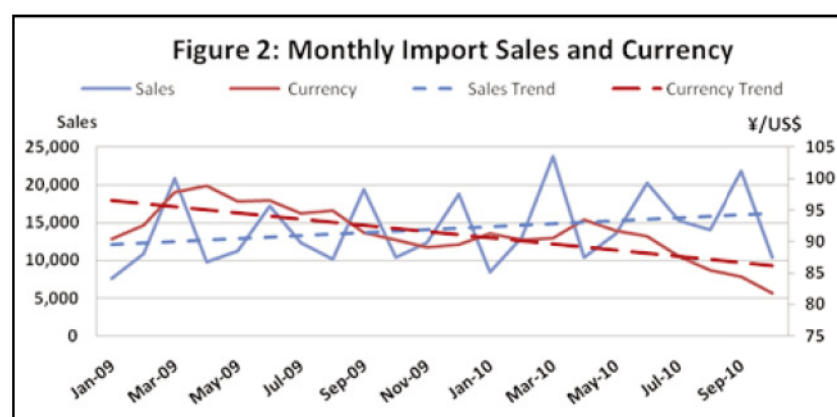
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Foreign branded imports do not have the luxury of plugging into national marketing strategies. They need to behave more tactically, reacting to currency fluctuations as they occur. While the yen is strong, the importers can afford to go on the offensive. According to the Daily Yomiuri, the English language version of one of the biggest selling newspapers in Japan, price reductions have been widespread. BMW was reported to be offering a ¥100,000 (US\$1,230) discount on certain Minis, and discounting up to ¥200,000 (US\$2,460) on various BMW branded cars, the same level as Audi. Mercedes-Benz appears to have been making the deepest cuts, offering up to ¥400,000 (US\$4,920) on particular models.

Volkswagen and Fiat were reported to be taking a slightly different marketing tack by funding an environmental car incentive similar to the Japanese government's, except that the ¥100,000 - ¥150,000 (US\$1,230 - US\$1,840) subsidies will be sourced from company funds even after the government scheme has been withdrawn.

Given that the importers are able to do this on the back of the currency appreciation, they are buying market share at little cost to themselves. Figure 2 shows how the increase in import sales has mirrored the rising currency, including the latest data for October 2010. The currency valuation axis is shown on the right, and linear trend lines have been added to aid the interpretation.



### Yen corrected

In a surprise move, the Japanese Prime Minister, Naoto Kan, attempted to curry favour with his party by ordering a massive intervention in the currency markets in mid-September. This had the immediate effect of lowering the value of the yen, from a height of around ¥83/US\$ to nearly ¥86/US\$. This was a unilateral move to help Japanese exporters, who claim they need an exchange rate of at least ¥90/US\$ for overseas sales to be viable. If this is the target then further interventions will be needed, thereby snatching the price advantage away from the importers once more.

However, the Prime Minister's political ambitions will not be enough to turn back the economic tide. Both the US and the Eurozone are dogged by a seemingly eternal trickle of bad news. There had been a hope that a fall in their currencies would boost exports and kick-start the economic recovery. However, now that Japan has joined with China in suppressing their currency valuations it was almost inevitable that the US would be obliged to use further quantitative easing measures. The US economic strategy was purportedly to boost domestic liquidity, but it is also pushing down the dollar on the foreign exchanges. While an outright war of exchange rates is unlikely, the game of brinkmanship amongst the currencies will preclude the emergence of a clear winner.

The importers have probably always been aware of their predicament, which is why they have been offering selective discounts rather than simply lowering their prices across the board.

In any case, with the US and the Eurozone bogged down in a recessionary mire, Japan will continue to offer a relatively safe haven for currency investors. Even though the Japanese government's stance hints that a level of ¥83/US\$ would not be tolerated, the return to quantitative easing by the US Federal Reserve has undermined the Japanese strategy. By the second week of November, the yen was at nearly ¥80/US\$.

### Imports in the vice

The other problem facing the importers in Japan is the power of the domestic manufacturers. Considering the strength of Japanese competition in overseas markets, it is hardly surprising that they are able to dominate every niche and segment of their home market. Indeed, there has never been a sensible reason for buying a foreign car in Japan. Import sector demand tends to be the preserve of independent thinkers and mavericks, two social groups that have never been known for their prominence in the Japanese market. In any case, the local car manufacturers have plenty of niche models of their own to offer these exclusive consumer groups.

The import sector is effectively caught in the jaws of a vice, between the hegemony of the local brands and the political imperative to reduce the value of the currency. The importers have probably always been aware of their predicament, which is why they have been offering selective discounts rather than simply lowering their prices across the board.

For the time being, we can expect to see the improvement in sales volumes to continue for the rest of the year, and perhaps into the first half of 2011. Fundamentally, though, the Japanese import sector will remain a footnote to the mass market.

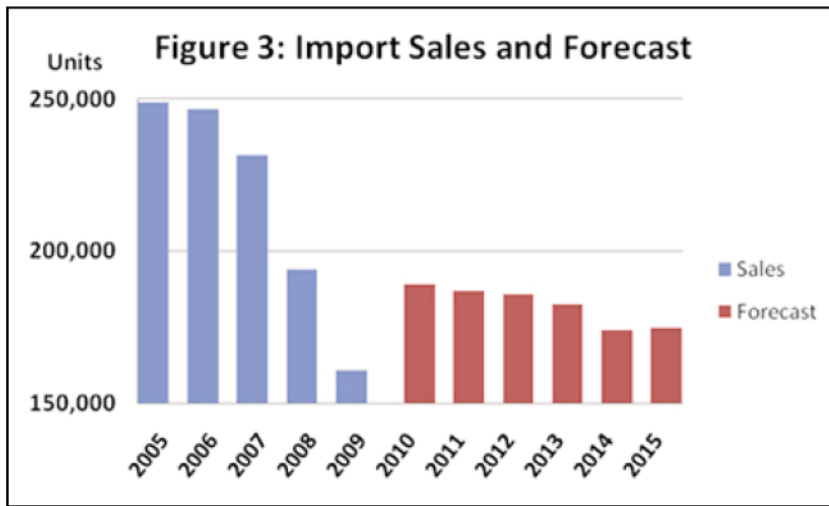


Figure 3 shows the degree to which the price advantage enjoyed by the import brands is boosting sales during 2010. Yet with the recession still firmly entrenched there is little possibility of returning to the levels of even 2008, let alone the heights of previous years. The data for October showed that import sales for the year so far are ahead by around 16%, but absolutely flat for the month. From mid-2011, the major currencies of the world should have returned to some sense of normality, meaning that the price advantage for imports will have been eroded.

For the longer term, Japanese manufacturers will need to address their heavy reliance on exports. As global demand is increasingly served by regional production centres, the Japanese production sites will focus more on the home market. In addition, demographic changes mean that these automotive giants will be fighting over a shrinking Japanese market.

With Japanese deflation resistant to eradication, the domestic manufacturers have their own downward pressure on prices. Under these circumstances, importers will be doing well if they can hold onto what little market share is left, and ensure that their position is financially viable. Any growth during 2010 will simply be a case of making hay while the yen shines.

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