Auto prospects tied to economic reforms

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THE auto market seems to have another good year. In the first half of 2013, wholesales of passenger cars made in China increased by 18 percent from a year before. However, we believe that the growth rate will decrease to about 10 percent until the end of the year, mainly because dealers face a hard time getting bank loans and because car demand will decrease once the size of the wealth management products sector decreases.

Compared with last year, the pressure will not come from the luxury end of the market. Imports fell 8 percent in May from a year before. Import dealers have high inventories at an average of 80 days and have decreased their orders.

This time, BMW, Audi and Mercedes will exert less pressure than last year. The US premium market is back at the level of 2007, and, from the corporate point of view, a better geographical spread is preferable. Many car buyers in the US are probably Chinese anyway, since Chinese dominate the market for houses priced at US$1 million right now and many of these Chinese families will buy expensive cars as well.

The average dealer inventory for many brands exceeds the danger level of 45 days. The average for foreign brands stands at only 42 days, so that we don't see an immediate problem. But the average inventory for dealers of Chinese brands stood at 61 days in May, with brands like Geely reaching 81 days.

Dealerships presently find it difficult to keep or increase their credit terms with banks. The situation becomes more severe as inventories rise. Many Chery dealers are going down that road already, with 27 of them closing or switching to other brands in the first quarter of this year.

The success of the wealth management products has steered many households away from bank deposits, leaving banks with less liquidity for lending. Most loans are now channelled through "shadow banking," which are fuelled by wealth management products to a large extent. Loans from trusts come with interest of 20 percent a year, a rate taken up only by companies with their backs to the wall. It is not a rate a car dealership, for example, could afford for long.

We see the liquidity squeeze in June as a sign that the new government really intends to change the structure of the economy.

The squeeze sent a message to banks to reduce their exposure to wealth management products, entrusted loans and bankers' acceptances and return to lending under the stronger, regulated part of the financial system. We expect that the reserve ratio for banks will be decreased and wealth management activities will be required to appear on banks' balance sheets.

Moral hazard

However, this strategy will work only if households are informed that wealth management products don't have an implicit guarantee by the central bank. The bailout of the failed product sold by the Huaxia Bank in December 2012 has created a moral hazard.

Wealth management products currently have an average annualized return of more than 5 percent, compared to savings deposits that yield only 3 percent. Some products have an annualized return of 9 percent. We explain part of the strong demand for cars by these profits because most Chinese households are target savers.

Another portion of returns went into demand for housing, which has seen rising prices again after being depressed from July 2011 to late 2012. Once wealth management products become less prevalent and deposits become the norm again, the demand for cars will decrease, especially if consumer inflation rises above 3 percent.

The effect of lower demand and better credit terms for dealers won't likely be felt until the last quarter of 2013.

Economic restructuring would generally lead to lower car demand in the short term. That could lead to the exit of certain Chinese original equipment manufacturers and other "zombie" companies mainly kept alive by subsidies from their local governments.

Real estate could take a hit, along with about 30 related industries. Overcapacity in those industries would be eliminated. There would probably be some quantitative easing in the form of lower reserve ratios, but flooding the market with too much money could lead to inflation in 2014.

Local governments would have to tighten their belts and could afford only lower levels of new infrastructure, which would lead to even more pressure on the construction industry. The restructuring of the economy could take years. If policymakers follow the current plan, the economy would be much more stable and demand for cars would sustainably grow for decades to come.

Chasing dreams? Luxury car sales depend on it

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AS a child, who never said, "When I grow up I want to drive a Ferrari or a Lamborghini?" And who never stood in front of a fancy car dealership window, dreaming about a premium car parked in the family garage?

It's not just kids who fantasize. That was clear when I moved to Shanghai, where the dream of owning a luxury car takes on manifold proportions.

China's luxury car market has become much more crowded in the last five years. In 2008, premium car buyers had 10 models under five brands to choose from the showrooms. Five years later, the number has risen to 90 under 25 brands, accounting for 9 percent of the total car market. Luxury models are scattered across various car segments, from small to full-size sedans and SUVs, where the market share of premium brands peaked close to 17 percent in the first six months of 2013.

In this amazing expansion, the portfolio of traditional German brands has been stretched widely. The traditional Saloon S class of Mercedes-Benz has an alphabet of model-mates — A, B, C, CLS, G, GL, GLK, M, R, S, SL, SLK and SLS. BMW is extending its current range to retain its customer base by addressing their ever-changing needs; for instance a MPV is in the pipeline for a family of three. Audi, Land Rover, Infiniti and other manufacturers have been following the same line of extension across segments to ensure they provide attractive propositions to every type of new car buyers. The aim is to cover the entire market, not just niches.

Despite a relative economic downturn and despite car plate restrictions in big cities, the success of premium and luxury cars remains undeniable. The growth of historic players like Audi, BMW, and Mercedes-Benz has been maintained even as new players enter the market. All of this represents a fantastic opportunity for car fans looking for a premium driving experience to shop around, compare prices and choose a model that will exhilarate their senses.

For carmakers, the challenge is to attract new customers and instill customer brand loyalty. That requires careful attention.

Naturally, to be purchased, models need to be known, but they also need to be recognized by others as a mark of differentiation. A dealer network is obviously critical to capture selling opportunities. Automakers also need to align the standard of their products, in the sense of design, quality, equipment and service, to the level of expectation of demanding Chinese customers. Let's take a closer look at some of these factors.

Car design. Due to frequent business use of cars, a buyer may need to provide clients, the boss or even workmates a pleasurable journey. Chinese premium car buyers want more leg space and more comfort features in the back seats. Manufacturers who deliver models with extended wheelbases and proven safety features have the advantage.

Car manufacturing. Chinese premium car buyers always push for locally produced cars with European standards of quality and craftsmanship. If they are paying a premium price for a car, they expect superb quality in return.

Client service. Public criticism of after-sale service for top performance cars posted on the Internet reminds us that the quality of service delivered to end-customers has to be as outstanding as the car's performance. There is no room for compromise.

Innovation and novelties. Luxury cars are subject to fashion trends. They are discussed, compared, adored or criticized off-line as well as online. Innovation, new model introductions and launch events are necessary to "stay in the spotlight."

Finally, superseding these rather logistical elements, premium brands have to touch the hearts of their customers. Like jewelry, luxury cars must convey values, promise and the image of wealth and status.

Looking at the China market, one can identify three lifestyle trends that luxury automakers need to consider.

The connoisseurs. These are people interested in technical details, engineering and design elements that have a bearing on the performance, control or safety of driving. They believe that advanced technology enhances the driving experience.

The easy-going self-focused. These are people who look for more comfort and more personalization in a car. Their perfect model is one that handles easily and provides a high level of comfort — a form of cocooning. They will be less constrained by the opinions of others, preferring to rely on their own emotions. We do see in China the increased popularity of the personalization of cars through options, accessories and customer service.

The fashionsistas. These are people who like to be at the forefront of trends to display their individualism and self-confidence. They enjoy being the focus of attention. They are more influenced by Western values and the small but fashionable cars.