AT A GLANCE | China

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Chinese Auto Sector's Growing Presence in the Global Markets

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China's economy is generally lackluster, with no significant growth acceleration likely. On the other hand, in terms of sectors, there are some industries that are showing growth momentum, most notably the automotive industry.

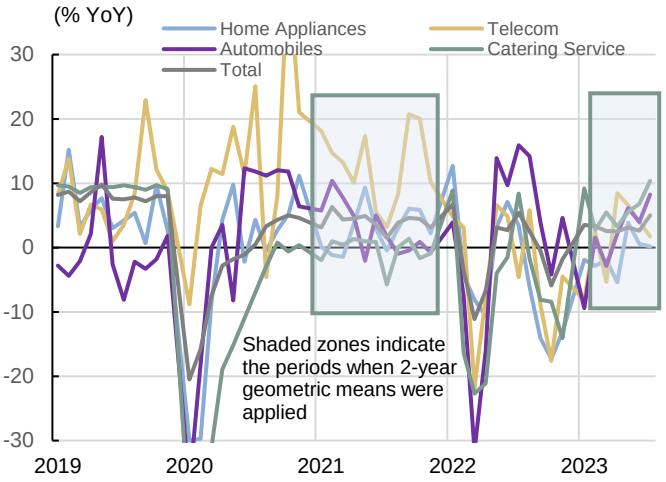
If we look at the breakdown of domestic consumption, investment and production indicators, the automotive sector is generally strong (Figures 1, 2, 3). Of these, local brands have steadily increased their share of the domestic market (Figure 4). In addition, as widely reported in Japanese media, the number of vehicles exported from China in the first half of 2023 (January-June) increased significantly to 2.14 million units, with China becoming the world's top exporter for the first time, surpassing Japan.

Industry experts have noted the unusually high presence of Chinese automakers at the Shanghai Motor Show in March and the IAA Mobility 2023—the world's largest motor show—in Munich, Germany, in early September.

From a macroeconomic perspective, the automotive industry has a wide range of related industrial chains and, like the real estate industry, it has a large ripple effect on the overall economy. On the other hand, unlike the real estate market in China, which is not expected to expand further (see the main section of the September 1 issue), the domestic automobile market in China is still in the process of expanding, and there is also an opportunity to gain market share overseas by riding the trend of switching to electric vehicles (EVs, see below).

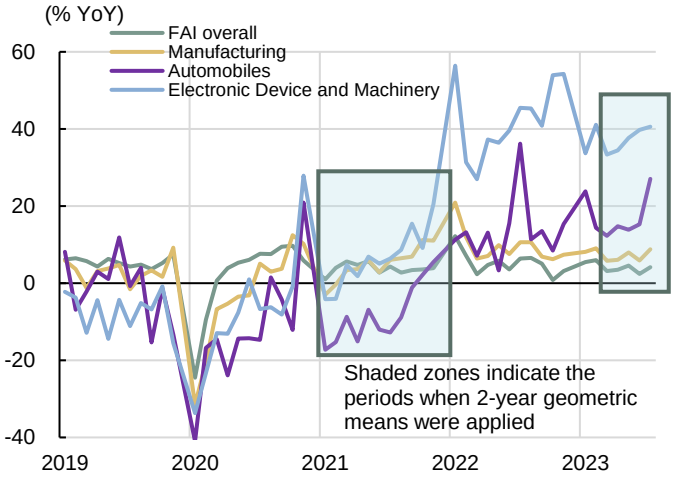
Therefore, the automobile sector is expected to be a pillar of China's economic growth in the post-real estate era. In this report, we would like to summarize the domestic and international trends in the Chinese automotive sector.

Figure 1: Retail Sales (YoY)



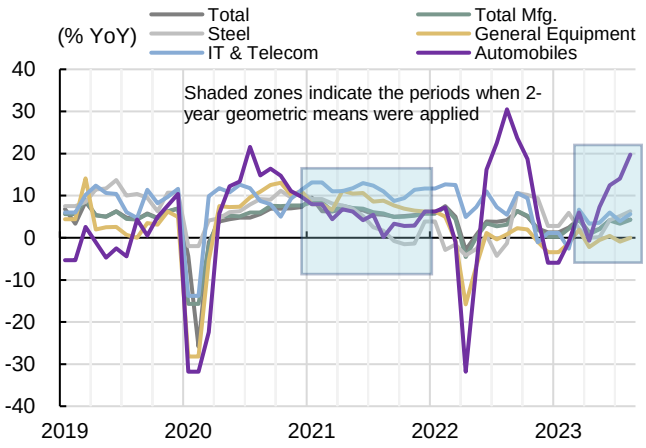
Sources: China National Bureau of Statistics, Wind

Figure 2: Investment in Fixed Assets – Automotive Business (YoY)



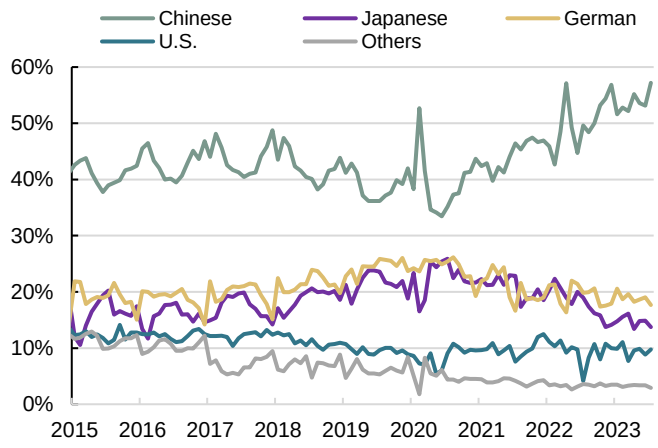
Sources: China National Bureau of Statistics, Wind

Figure 3: Industrial Production (YoY)



Sources: China National Bureau of Statistics, Wind

Figure 4: Automobile Sales Market Share by Brand Country



Sources: CAAM, Wind

Local Companies Push Into the Domestic Market, Which Still Has Room to Expand

In determining the extent to which durable goods sales in emerging economies can grow in the future, the amount of such goods held per population (household) is a guide. Although China already ranks first in the world in terms of sales, it had about 320 million cars in total at the end of 2022, with an average of about 0.6 cars per household, meaning that at least 40% of households do not own their own cars. Given that Japan has about 1.0 and the United States has about 1.9, potential demand is still large.

In major countries, there is a positive correlation between the number of vehicles owned per 1,000 people and disposable income per capita (Figure 5). If per capita disposable income were to double from 2020 by 2035, as the Chinese authorities have laid out in their long-term vision, the number of cars owned in China would at least double over the next 10 years, based on the correlation shown in Figure 5.

Of course, in order to meet latent demand, it is necessary to provide products that satisfy various requirements of consumers. Currently, the core price range for domestic car consumption is 100,000-200,000 yuan, accounting for approximately 50% of market share.[1] In addition, the need for EVs continues to grow. What consumers want from EVs is that the priority given to the quality of the product itself (maneuverability, maintenance convenience, etc.) greatly exceeds brand and policy factors (tax benefits, license plate restrictions, etc.).

These demands have been met by local Chinese brand automakers. It has often been observed that locally branded products changed qualitatively in the second half of 2020 due to policy support such as tax breaks for corporate research & development investment and the establishment of supply chains by attracting major American EV companies, as well as a sense of competition.

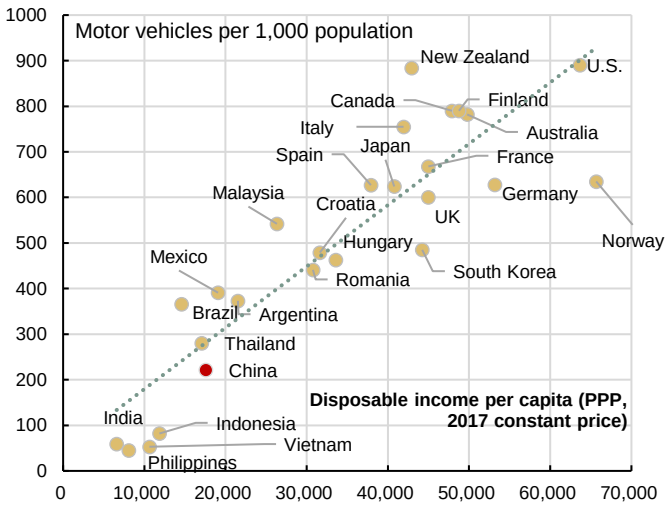
Around this time, new models of local brands, mainly in the 100,000-200,000 yuan price range, were continuously introduced to the market and received good reviews from consumers. Subsequently, there has been a virtuous cycle in which local companies develop more competitive products based on consumer feedback, etc., and further expand their market share.

German and Japanese automobiles, which have maintained a stable market share in China for a long time, have been losing market share in recent years, partly because of the delay in responding to the preferences of Chinese consumers. In addition, since the second half of 2022, there has been an unprecedented event in which joint-venture brands continuously outnumber local brands in the number of months of sales of inventory held by automobile dealers (Figure 6), which reveals consumers' preference for local brands and their disengagement with joint-venture brands. Under these circumstances, a new cooperative relationship was established in which major German companies introduced technology from local Chinese companies and jointly developed new models for the Chinese market with Chinese companies.[2] This suggests that local Chinese companies are becoming more competitive.

1 McKinsey, "2023 China Auto Consumer Insights". pdf: https://www.mckinsey.com.cn/wp-content/uploads/2022/12/2023 Barley Affirmation

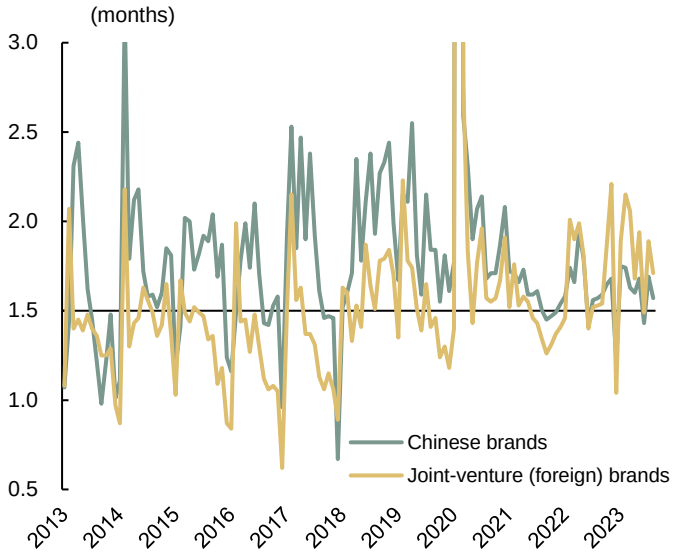
2 https://www.autohome.com.cn/news/202307/1286865.html. [LINK1] In the past, foreign companies provided the "hardware", such as production and technological development, while Chinese companies took charge of the "software", such as sales and marketing. This was the main form of cooperation between Chinese and foreign automobile companies.

Figure 5: Disposable Income and Automobile Ownership in Major Countries



Note: Disposable income data are on year 2021. Vehicle numbers are the latest available data of years 2020-2022.

Figure 6: Car Dealer Inventory (Months)



Sources: CADA, Wind

Chinese Companies Expand Overseas in Earnest

China's automobile exports have surged since the second half of 2020, and its monthly exports are now at the same level as those of Japan and Germany, which are traditionally recognized as major automobile exporters. In January-August 2023, China exported approximately 2,454,000 passenger cars (+69.7% YoY or +1,008,000 units from the previous year), which is already close to the full-year export of 2,525,000 cars in 2022.

Of course, following the withdrawal of major global auto companies from Russia under Western sanctions, Russia has significantly increased its imports from Chinese auto companies as an alternative (just under 400,000 more vehicles than in January-August last year), which has contributed significantly to the recent increase in auto exports. It is difficult to conclude that Chinese companies have developed the market based on their product competitiveness, and there is still a lot of uncertainty about whether automobile exports to Russia can increase steadily from next year.

On the other hand, among new energy vehicles (NEVs) exported in January-August of this year, passenger car exports increased by about 500,000 units from the same period of the previous year, with a marked increase in Western Europe and Southeast Asia (Figure 7).[3] The Shanghai plant of a major American EV manufacturer is operating at full capacity and remains the leading exporter of NEVs, but the overall export ratio has shrunk from 26.8% in January-August of last year to 21.6% in January-August of this year, confirming the gradual rise of local brand EV exports.

Of note is the European market. Europe has announced an aggressive decarbonization strategy and a plan to halt sales of internal-combustion vehicles, making it easier to expand EV sales channels and selling at a higher unit price than in other regions. The U.S. market will be the main overseas market for Chinese auto companies in the medium term, but the U.S. still imposes an additional 25% tariff on Chinese cars, so it will be difficult to expand sales channels in the short term.

3 This includes pure electric vehicles (also known as battery electric vehicles, or BEVs), plug-in hybrid electric vehicles (PHEVs) and fuel cell vehicles (FCVs). More than 90% of new energy vehicle exports are BEVs.

But the European Commission's September 13 announcement that it would launch an investigation into subsidies for Chinese electric vehicles is cause for concern. If the investigation finds that Chinese EVs engaged in unfair competition based on subsidies, additional tariffs may be imposed on Chinese EVs beginning in October 2024 at the latest.

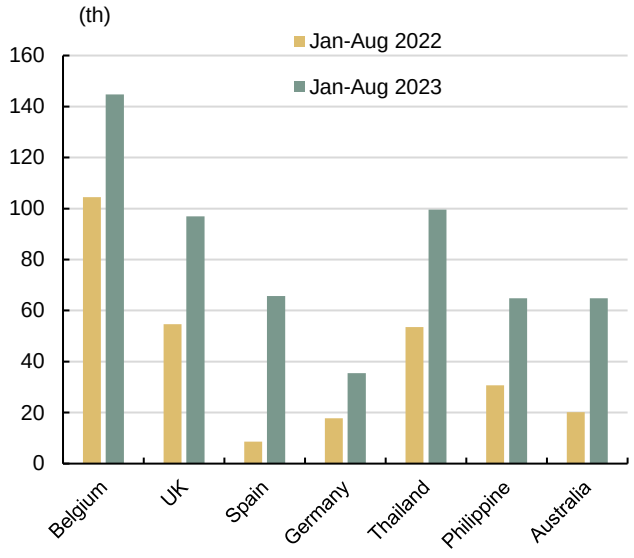
On the other hand, Chinese companies are considering sharing profits with European companies and governments through increased investment in Europe as a means of easing trade tensions with Europe. In recent years, not only finished vehicle companies but also Chinese suppliers of EV components such as batteries plan to establish production and development bases in Europe (Figure 9).

France is leading the European Commission's subsidy investigation, but it may also be a bargaining chip to attract Chinese EV companies to set up local factories. In other words, the European Commission's subsidy investigation will not necessarily conclude with the imposition of additional tariffs on Chinese EVs, and the possibility of expanding sales channels in Europe remains.

Although it is unlikely to be a major source of profit outside Europe in the short to medium term, there have been recent moves by Chinese automakers and component suppliers to establish production bases in Thailand, Brazil and other countries in order to meet potential long-term demand in emerging markets in Southeast Asia and South America (Figure 9).

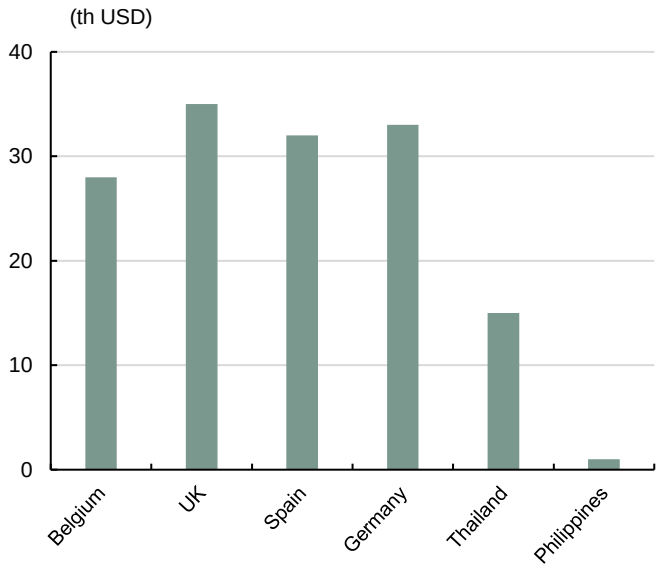
After two oil shocks in the 1970s, export sales of fuel-efficient Japanese cars increased significantly. Although trade friction with the United States arose thereafter, the internationalization and sophistication of Japanese car brands advanced further through local production. It will be interesting to see if the same story can be realized in Chinese EV cars.

Figure 7: New Energy Passenger Car Exports to Major Countries



Source: CPCA

Figure 8: Average Unit Price of Chinese EV Exports (August 2023)



Source: CPCA

Figure 9: Trends of Major Automotive Companies' Overseas Expansion

Sector	Company	Plan/Action of Overseas Expansion
Finished Car	SAIC	**Jul. 2023 Decision to set up a factory in Europe. Considering location.**
		Apr. 2023 Commenced construction of an EV part factory in Thailand. Plans to complete Phase 1 and start production in Oct. 2023.
	BYD	**Jul. 2023 Commenced construction of an integrated factory of finished cars, batteries and other EV parts in Camaçari, Brazil. Plans to start production in the first half of 2024.**
		May 2023 Reported to be in negotiation with the French government over the setup of a local factory. Aims to begin operation of a European factory before 2025.
		Mar. 2023 Commenced construction of a finished car factory in Thailand. Plans to start production in 2024.
	Geely	**Jul. 2027 Group company Volvo announced a new BEV-specified factory in Slovakia. Plans to start construction in 2023 and production in 2026.**
	Changan Auto	**Aug. 2023 Sets up local corporation in Thailand and announced plans for local NEV factory.**
	Great Wall Auto	**Jan. 2022 Acquired a former Mercedes factory in Brazil and rebuilds it into an NEV factory. Plans to start production in May 2024.**
Power Battery	CATL	**Jan. 2023 Started operation of German battery factory.**
		Sep. 2022 Announced plan of Hungarian battery factory. Plans to start operation in 2025.
	EVE Energy	**Jun. 2023 Announced plan of Hungarian battery factory.**
	Gotion	**Jun. 2022 Started construction of German battery factory. Delivery will start in Oct. 2023.**

Source: SMBC

Economic Outlook: 2023-2024 Forecast

Figure 1: Forecasts for Economic Growth, Inflation, and Unemployment Rates

		2022			2023				2024				2021	2022	2023	2024
		Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
US	Real GDP	−0.6	2.7	2.6	2.2	2.1	2.5	1.2	0.6	1.0	1.2	1.7	5.9	2.1	2.1	1.2
	Inflation	5.2	5.2	5.1	4.8	4.6	4.0	3.6	3.0	2.7	2.6	2.5	3.3	5.0	4.2	2.7
	Unemployment	3.6	3.6	3.6	3.5	3.6	3.7	3.9	4.2	4.4	4.4	4.5	5.4	3.7	3.7	4.4
Euro Area	Real GDP	0.8	0.3	−0.1	0.1	0.1	0.0	0.1	0.2	0.3	0.3	0.4	5.6	3.4	0.5	0.8
	Inflation	8.0	9.3	10.0	8.0	6.2	5.1	3.2	3.3	3.2	3.0	2.8	2.6	8.4	5.6	3.1
	Unemployment	6.7	6.7	6.7	6.6	6.4	6.5	6.6	6.7	6.8	6.8	6.8	7.7	6.7	6.5	6.8
Japan	Real GDP	5.3	−1.2	0.2	3.2	4.8	0.9	0.8	0.9	0.9	1.1	1.1	2.2	1.0	1.5	1.0
	Inflation	2.1	2.7	3.8	3.5	3.2	2.9	2.5	2.9	2.8	2.5	2.1	−0.2	2.3	3.0	2.6
	Unemployment	2.6	2.5	2.5	2.6	2.5	2.4	2.4	2.3	2.3	2.3	2.3	2.8	2.6	2.4	2.3
China	Real GDP	0.4	3.9	2.9	4.5	6.3	4.4	4.8	3.7	4.1	4.6	5.0	8.4	3.0	5.0	4.4
	Inflation	2.2	2.8	1.8	1.3	0.2	0.0	0.6	1.1	1.5	1.8	2.0	0.8	1.7	0.5	1.6
	Unemployment	5.8	5.4	5.6	5.5	5.2	5.3	5.2	5.1	5.0	5.0	5.0	5.1	5.1	5.3	5.0

Real GDP growth is in QoQ annualized for U.S. and Japan, QoQ for euro area and YoY for China and India. Inflation rate is in YoY%. Inflation rate is YoY, % of core index (ex. fresh food) for Japan, YoY % of PCE deflator for U.S., and total YoY% for the rest.

Figure 2: Forecast for Rates

Interest rate		2022	2023				2024				2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
US	Policy rate	4.25 ~ 4.50	4.75 ~ 5.00	5.00 ~ 5.25	5.25 ~ 5.50	5.25 ~ 5.50	5.25 ~ 5.50	5.00 ~ 5.25	5.00 ~ 5.25	4.75 ~ 5.00	4.25 ~ 4.50	5.25 ~ 5.50	4.75 ~ 5.00
	2yr	4.43	4.03	4.90	5.00	5.00	5.00	4.75	4.75	4.75	4.43	5.00	4.75
	10yr	3.87	3.47	3.84	4.50	4.20	4.00	3.90	4.00	4.00	3.87	4.20	4.00
Germany	Policy rate	2.50	3.50	4.00	4.50	4.50	4.50	4.50	4.25	4.00	2.50	4.50	4.00
	Deposit rate	2.00	3.00	3.50	4.00	4.00	4.00	4.00	3.75	3.50	2.00	4.00	3.50
	2yr	2.50	2.68	3.20	3.20	3.00	2.80	2.60	2.40	2.30	2.50	3.00	2.30
	10yr	2.20	2.29	2.39	2.80	2.50	2.30	2.20	2.10	2.10	2.20	2.50	2.10
Japan	Policy rate	−0.10	−0.10	−0.10	−0.10	−0.10	−0.10	0.10	0.10	0.10	−0.10	−0.10	0.10
	2yr	0.04	−0.06	−0.07	0.06	0.15	0.20	0.30	0.30	0.30	0.04	0.15	0.30
	10yr	0.42	0.35	0.40	0.77	0.75	0.80	0.90	0.90	0.90	0.42	0.75	0.90
China	Policy rate	2.75	2.75	2.65	2.50	2.40	2.40	2.40	2.40	2.40	2.75	2.40	2.40
	2yr	2.39	2.41	2.11	2.20	2.10	2.18	2.25	2.35	2.45	2.39	2.10	2.45
	10yr	2.83	2.85	2.64	2.60	2.55	2.60	2.65	2.70	2.75	2.83	2.55	2.75

Figure 3: Forecast for FX and Oil Price

		2022	2023				2024				2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
USD/JPY	Range	130.58 ~ 151.95	127.23 ~ 137.91	130.64 ~ 145.07	137.25 ~ 149.71	133.00 ~ 147.00	131.00 ~ 145.00	126.00 ~ 140.00	128.00 ~ 142.00	128.00 ~ 142.00	113.47 ~ 151.95	127.23 ~ 149.71	126.00 ~ 145.00
	End of quarter	131.12	132.86	144.31	149.00	140.00	138.00	133.00	135.00	135.00	131.12	140.00	135.00
EUR/USD	Range	0.9633 ~ 1.0735	1.0806 ~ 1.1033	1.0635 ~ 1.1095	1.0488 ~ 1.1276	1.0200 ~ 1.1200	1.0100 ~ 1.1100	1.0000 ~ 1.1000	1.0100 ~ 1.1100	1.0100 ~ 1.1100	0.9536 ~ 1.1495	1.0200 ~ 1.1276	1.0000 ~ 1.1100
	End of quarter	1.0705	1.0839	1.0909	1.0550	1.0600	1.0500	1.0500	1.0600	1.0600	1.0705	1.0600	1.0600
EUR/JPY	Range	138.81 ~ 148.40	124.40 ~ 145.67	142.55 ~ 158.00	151.42 ~ 159.76	144.00 ~ 158.00	138.00 ~ 152.00	133.00 ~ 147.00	136.00 ~ 150.00	136.00 ~ 150.00	124.40 ~ 150.00	137.39 ~ 159.76	133.00 ~ 152.00
	End of quarter	140.41	144.01	157.43	157.20	148.40	144.90	139.65	143.10	143.10	140.41	148.40	143.10
Crude Oil Prices (WTI)		82.64	75.99	73.67	82.23	82.00	82.00	76.00	77.00	78.00	98.74	78.47	78.25

※ Crude oil prices are averages for each period. Source: SMBC.

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