



THOMAS MAWICK  
 Manager Studies & Network Design  
 thomas\_mawick@polk.com

## Japanese Natural Disasters Yields Revised Auto Forecast

The consequences of the March 2011 earthquake and tsunami have been severe for the Japanese people, country and economy, and Japan is currently going through one of the worst crises in its history.

As hard as it is to get back to the daily routine under these circumstances, it is necessary for us to consider the potential impact of these events on the automotive industry. Polk has examined this issue and presents its revised forecast assumptions, as well as its estimate of the potential impact on the automotive industry. It should be kept in mind, however, that the news can change at any time, and these changes may result in altered scenarios.

### Assumptions

We entertain the following assumptions:

- A massive nuclear disaster, which would have grave inter-regional consequences for the population and the economy, will be avoided.
- The earthquake, tsunami and reactor incident will have a regional and temporary impact.
- Japan's economy will go through a temporary shock, including a stock market crash and temporary production losses, after which many companies will begin to make up ground.
- However, a grave impact on the global economy in 2011 is not expected.
- Investments to rebuild infrastructure in the affected regions are progressing relatively quickly. However, the structural impact is grave and the financial impact is not yet foreseeable, but a tax increase will be necessary to finance reconstruction.
- The strength of the Yen will make things even more difficult for Japan's heavily export-oriented economy.

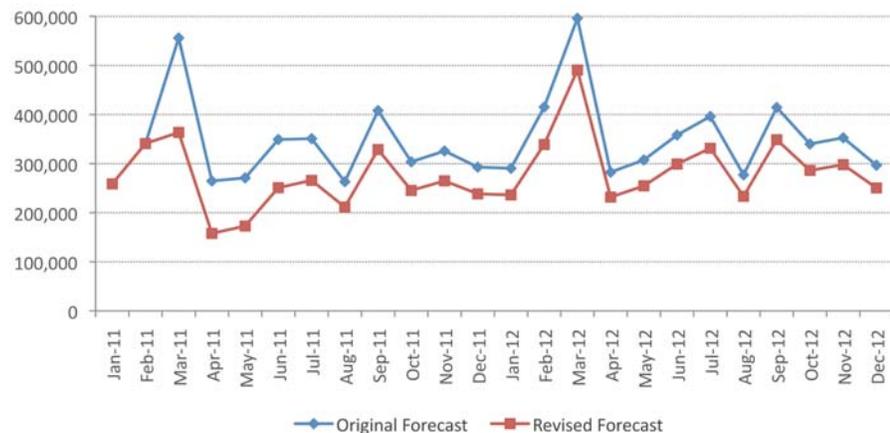
The impact on the automotive industry affects the entire value chain. Suppliers and manufacturers have temporarily suspended production. As of this writing, there continue to be interruptions in the supply of critical parts impacting vehicle production in numerous global markets. Passenger vehicle demand will experience a structural break as a result of the aforementioned events. The impact of this break will be exaggerated at first by supply shortages affecting manufacturers and the psychological consequences of the disaster, after which demand will begin to recover. Replacement demand is particularly high in the regions affected by the disaster.

We have therefore revised our forecast for the Japanese market as follows:

- The demand slump which began in March 2011, undoubtedly will affect the coming months. **For 2011 as a whole, passenger vehicle demand is now expected to be 3.1 million units, 22% less than before the disaster.**
- The negative impact will gradually subside as the year goes on, but the market's general trend level is expected to decrease.
- Repairing the damages caused by the earthquake and the flooding will require a financial effort which will presumably necessitate tax increases and, consequently, reductions in disposable income. As a result, **we have reduced Japan's long-term demand trend by about 450,000 units a year.**
- Passenger vehicle demand will presumably exceed this new long-term demand trend starting in 2014 as a result of pent-up demand. Nevertheless, **demand will miss the old forecasts by an estimated 360,000 units in 2014 and 220,000 units in 2015.**

“The demand slump which began in March 2011, undoubtedly will affect the coming months. For 2011 as a whole, passenger vehicle demand is now expected to be 3.1 million units, 22% less than before the disaster.”

Figure 1: Short-term Development – Original versus Revised Japanese Market Forecast (2011–2012)





## Japanese Market Profile

The Japanese passenger vehicle industry can be roughly described with the following characteristics:

- It is largely a saturated market; high percentage of replacement demand (over 90%), low new demand
- Low import rate (less than 5%)
- Domestic *production* is about twice as high as domestic *demand*
- Roughly half of all domestic production is exported
- The largest export market is the American continent, followed by Europe and other Asian markets
- Japanese manufacturers have the ability to partially offset lost production in Japan by increasing production in foreign plants

We do not expect a measurable decrease in demand for Japanese models in the country's export markets and, if so, this effect will be short-lived. We also see the current decrease in production among international OEMs due to the inability to obtain electronic components from Japan as a temporary phenomenon. Our forecast does not take into account the potential impact of shortages on electronic components which may drive their component costs upward.

Based on these assumptions, the impact of the disaster in Japan on the automotive industry will be largely limited to a loss of demand within the Japanese market.

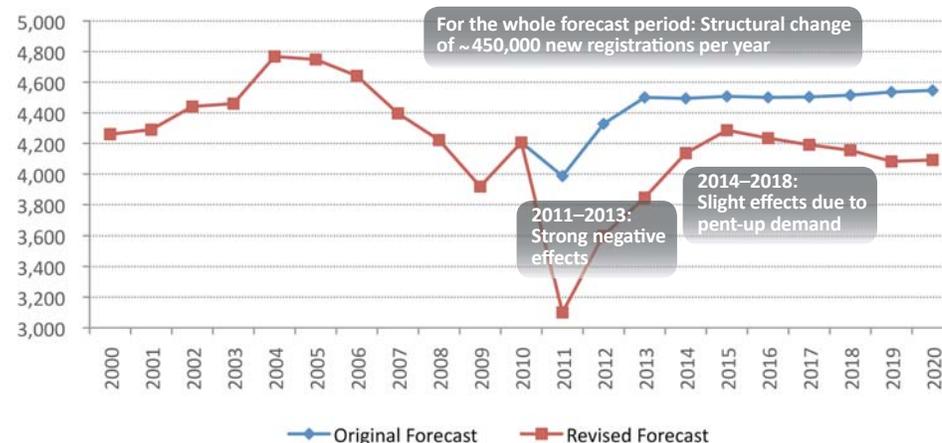
## Impact on Used Vehicle Demand

The Japanese used vehicle market will not have significant impact on the movement of the new vehicle market. As used vehicles are more affordable, especially for those who have been severely hit by the earthquake, there is no doubt that strong demand for used vehicles currently exists and will for some time.

Already a shortage of used vehicles has bottlenecked. As the Japanese vehicle market has been weak for the last couple of years, it is likely that trade-in vehicles supplying the used vehicle market will decrease. In addition, the Japanese government is considering offering exemptions from vehicle acquisition tax and vehicle weight tax for those replacing their vehicles in highly damaged areas.

Considering this, price hikes are expected on used vehicles due to a supply-demand imbalance and new vehicles will become relatively more affordable with tax breaks, meaning that the price advantages of a used vehicle over a new vehicle will diminish. Therefore, we foresee that the used vehicle market will not eat away vehicle replacement demand from the new vehicle market in the short term.

Figure 2: Medium & Long-term Development – Original versus Revised Japanese Market Forecast (2011–2020)



## ABOUT POLK

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