KOREA'S AUTOMOTIVE INDUSTRY IN THE SECOND HALF OF 1999

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Domestic Market Rebounding

Domestic auto sales rose markedly in the 1st quarter of this year. Starting from the 4th quarter of last year, the decline in monthly sales on a year-on-year basis started to shrink, and this January the monthly sales growth rate year-on-year turned around sharply, rising to 73%. The positive y-o-y growth in monthly sales was the first since September 1997, just before the foreign exchange crisis broke out. This positive trend continued through March and domestic auto sales in the 1st quarter of this year rose 55.5% over the same period last year reaching 243,135 units.

There are several reasons for this faster-than-expected recovery of domestic market. More than anything, the background behind the recent surge lies in the recovery in consumption sentiment with the expectation of an economic recovery. The rise in asset values has restored upper-income groups' leeway for consumption, and the drop in interest rates and the easing of the credit crunch has helped boost sales of consumer durables such as automobiles. Looking at the auto market by itself, additional factors include the materialization of the expected demand which went unrealized after the start of the economic crisis, the lowering of auto-related taxes, and the stabilization of supply and A/S after industry restructuring, among others.

With the continuing recovery trend since the

Table 1. Korean Automotive Sales and Production

(unit, (%))

			1996	1997	1998	1999. 1~3
Domestic	Sales		1,644,132 (5.7)	1,512,935 (-8.0)	779,905 (-48.5)	243,135 (55.5)
		Cars	1,238,940	1,151,287	568,063	172,227
		CVs	405,192	361,648	211,842	70,908
	Exports		1,210,157 (23.7)	1,316,891 (8.8)	1,362,164 (3.4)	251,497 (5.9)
		Cars	1,056,400	1,155,893	1,228,144	228,380
		CVs	153,757	160,998	134,020	23,117
	Production		2,812,714 (11.3)	2,818,275 (-0.0)	1,954,494 (-30.5)	570,298 (31.1)
		Cars	2,264,709	2,308,476	1,625,125	474,690
		CVs	548,005	509,799	329,369	95,608

Source: KAMA (Korea Automobile Manufacturers Association).
Notes : Figures in parentheses are the growth rates over the same period of the previous year. Also, CV stands for commercial vehicles.

end of last year, some are going so far as to say that the domestic market has fully washed away from the effects of the economic crisis. However, based on this trend alone, it still seems too early to say that the domestic market has entered into a full-fledged recovery. In analyzing the situation, it should be remembered that the recent statistics on the domestic auto market are in comparison to the horrendous slump last year. There is also a reasonable possibility that the recent surge in sales is merely the sudden release of pent-up, suppressed demand largely due to the recovery in the purchasing power of the upper-income class. Furthermore, the unemployment rate currently tops 8% with the total number of unemployed nearing 2 million, and it is still difficult to say that the business cycle is in a full recovery stage. In addition, because of the reduction in wages and low job security, the middle- and lower-income classes still have strong uncertainties about consumption.

Starting from the second quarter, the increase rate should moderate slightly, but from the third quarter, the increase rate should rise again as new models are introduced and the economic recovery picks up steam.

Looking at the first quarter domestic sales of passenger cars by size, sales of high-priced cars such as large-sized cars (288.1%) and recreation vehicles or RVs (86.4%) rose the most year-on-year, which means that the revival in consumption sentiment mainly centers around the upper-income class and has not spread to the middle- and lower-income groups.

Forecast for the Second Half

Given the overall situation, it seems that explosive demand of the first quarter will not persist in the second quarter and second half of this year. First, the high unemployment rate is expected to stay in the 7%, and the economy is not expected to fully rebound until the second half. Since the current domestic market trends are largely influenced by the expectations of an economic recovery, the domestic auto market in the second half of this year will be significantly affected.

Another important factor which will help determine the size of the domestic market this year is how successful this year's new models are. By size, the new models to be introduced this year are concentrated in the small-sized car and RV segments. The RV sector will witness fierce competition because of the mass entry of new small-sized minivans and Jeep-type cars and is expected to register sharp growth with the greater emphasis on consumer utility. On the other hand, even though small-sized passenger car segment should show a slight recovery, the launching of new models might not have a big effect on market segment growth since this segment was already on a downward trend even before the start of the economic crisis. The absence of new models in the major mid-sized car sector is another factor which may limit market growth.

Meanwhile, the mini-car market is another crucial variable. Largely because of the effects of the economic crisis, the mini-car segment grew an explosive 81% last year accounting for 20.1% of the total market. However, this years, sales of mini-cars should fare much worse, given the revival of demand for bigger models, the relaxation of special mini-car promotion measures, and the introduction of the new small-size car models. It remains to be seen whether the other market segments will be able to make up for the slack in mini-car sales.

Given that the rapid jump in first quarter sales occurred without solid and substantial background, it can be expected that this huge surge will not continue in the second quarter and second half. Starting from the second quarter, the increase rate should moderate slightly, but from the third quarter, the increase rate should rise again as new models are introduced and the economic recovery picks up steam. For the year, sales should increase around 26% over the previous year, for a total of 980,000 units.

Exports, which grew a year-on-year 3.4% in 1998, should continue to show steady growth this year. Thanks to an aggressive marketing campaign including recent efforts to improve the image of Korean cars in advanced countries, extended service warranties, and a stabilized supply with the progress in restructuring, it is expected that exports to advanced markets such as North America and Western Europe will continue to grow. However, exports to developing countries, which have emerged and Korea's primary markets, will remain slow because of their slow economic recoveries. For the year, exports should increase about 7% or 1.46 million units.

Future Tasks for the Korean Auto Industry

It is forecast that domestic sales this year will recover from the nightmarish slump of last year, and now that restructuring of the Korean auto industry has been completed to a certain degree, the setting is in place for Korean car makers to take a new leap forward. However, this does not necessarily mean that Korean firms are completely out of danger.

Even though it is expected that the domestic market will steadily expand starting this year as the economy continues to recover, it will most likely take 2 to 3 years before it returns to the levels before the IMF era. Furthermore, while exports will continue to grow, it is hard to expect a huge increase considering the arowing international competition, rising trade tensions, and the continued recessions in developing countries. This means that the overcapacity of the Korean auto industry will persist for some time. Even though the number of players in the Korean auto industry has decreased, the surplus facility problem just began to be addressed.

As a result of this restructuring process, the surviving two makers have secured the basis for economies of scale. However, to obtain true synergy, the two firms must strive for effective platform integration and subsequent appropriate product diversification. Also, the restructuring of the auto making industry must lead to changes in the parts industry. Given the weak foundation of the Korean parts industry, the car makers must take the lead in promoting the expansion and specialization of Korean parts makers and also help them to incorporate the growing global trend of modularization.

Smooth integration in restructuring and obtaining synergy effects and revamping the parts industry are the key factors which will determine the future of the Korean auto makers.

Furthermore, from the second half of this year restrictions on imports of Japanese cars will be removed and the domestic auto market will be completely open to imported cars. At first the effect will not be very significant given Japanese makers' cautious approach while the domestic market remains contracted. However, once the domestic market recovers, Japanese automakers' entry may have a serious impact particularly in the mid-size and large-size segments, where Japanese models have high price competitiveness. American and European models are also timing the introduction of new models, better service packages, and other market penetration strategies to be in synch with the impending recovery.

To summarize, this year, in the midst of unprecedented changes, Korean car makers stand at a forked path, their directional choice determining whether they will rise or fall. Smooth integration in restructuring and obtaining synergy effects and revamping the parts industry are the key factors which will determine the future of the Korean auto makers. They will help them to maintain their identity and survive in the time of global consolidation in automobile industry. VIP