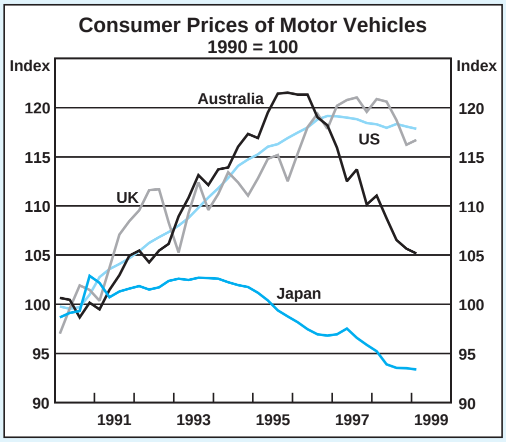
Box D: The Price of Motor Vehicles

Despite the large depreciation of the Australian dollar since the middle of 1997, prices for motor vehicles, particularly imported motor vehicles, have continued to decline. That car prices have declined to some extent is not unusual internationally over recent years (Graph D1). What is striking is the extent of the decline in Australia, particularly given the extent of currency depreciation.

Graph D1



The fall in prices at the retail level also stands in contrast to the rise of about 14 per cent in the price of imported cars as measured 'at the docks' (Table D1). There appear to be both international and domestic forces at work in producing this outcome. In explaining the divergence between dock and retail prices, two factors are probably important: *coverage* differences and *price determination*, including *discounting*, at the domestic level.

The CPI *coverage* of imported motor vehicle prices reflects the objective of measuring prices paid by households, and thus has a relatively high weight on the lower-priced vehicles from Asia, whereas measures of dock prices are intended to cover all imported vehicles, including more expensive European cars. In the past, prices for the two broad groups of cars rose at similar rates so this sampling difference did not drive a wedge between dock and retail price increases.

Over recent years, however, Asian car manufacturers have cut their export prices in US dollar terms. This was occurring prior to the onset of the Asian crisis, and has continued since then. Detailed ABS data on import values and volumes by origin measured 'at the docks' suggest that the average price of Korean cars fell by 18 per cent, in $A terms, between mid 1997 and March 1999. Over the same period, the

Table D1: Import Prices

	Share of the imported component of the CPI	Percentage change since June 1997 to: Dec 98	Mar 99	Mar 99
		Import price deflator	Import price index (IPI)	Import prices in the CPI
Total	100	8.9	10.4	-3.1
– Motor vehicles	16	10.9	13.6	-12.1
– Other goods	75	7.0	9.9	-1.2
– Overseas travel	9	11.5	..	-0.9

average price of cars from the US and Germany rose by around 20 per cent. A higher weight on Korean cars and lower weight on American and German cars in the CPI, compared with measures of dock prices, will thus have contributed to the recorded difference between movements in the two price series.

Discounting refers to cash-back offers/ rebates, free accessories and 'on the road' features such as extended warranties and free insurance. If the foreign supplier offers discounts to the importer, who in turn passes them on to the consumer, then the dock price, as well as the retail price, is in principle adjusted downwards. However, discounts in the form of free accessories still tend to cause a divergence between movements in dock and retail prices, since the domestic markups forgone on these accessories are typically much greater than those forgone by the foreign supplier.

If the exporter offers rebates directly to the consumer, or the importer initiates discounts, then only the retail price is affected and a divergence between movements in dock and retail prices arises. Anecdotal evidence suggests importers are responsible for the bulk of discounts. In particular, Japanese car prices have risen at the docks, but fallen at the retail level. These prices have a substantial weight in the CPI. Consistent with this, the available evidence on profit margins for wholesalers in the motor vehicle industry suggests they have fallen over the past few years. However, these falls may well have been less than that suggested by the fall in retail prices alone; cost cutting appears to have helped prevent too large a fall in overall margins.

A number of other explanations have been advanced for the divergence between dock and retail prices. For example, hedging by importers in 1997/98 may have delayed the need to increase prices. It seems likely, however, that hedging contracts of typical length for the industry would have expired some time ago. Reductions in car tariffs, which affect retail but not dock prices, will have contributed to downward pressure on car prices over time, although that appears to be insufficient to explain the emergence of a sharp discrepancy between retail and dock prices over the past year.

These explanations of the gap between measured import prices at the docks and those at the retail level still leave, however, the question of why some foreign suppliers have reduced their foreign currency price to Australian distributors and/or consumers. The global oversupply of small, low-priced cars, occasioned at least in part by the expansion of Asian manufacturers in the mid 1990s, is the most likely reason for general downward pressure on car prices. The currency depreciations in Asia have allowed some producers in that region to cut their foreign currency prices more aggressively than producers elsewhere. Both these factors would help to explain why importers, especially those that are linked to foreign suppliers, may have cut their gross margins. The fact that the Australian market is characterised by a much higher degree of importation than the United States – imports make up about half of vehicle sales in Australia, versus less than 20 per cent in the US – also does much to explain the bigger impact of international price cutting here.

It is likely, however, that some domestic factors have contributed. Despite price reductions, the share of Asian manufactured cars in the Australian market has barely increased since the middle of 1997. This suggests that domestic manufacturers, with improved productivity resulting from investment in new plant and changed work practices, have been able to compete effectively in the past few years.