RESEARCH

Automobile Market Outlook

Argentina

2012

Economic Analysis

- **Foreign-exchange restrictions and the slump in exports triggered a significant fall in production and sales in the automobile sector in 2012,** although sales to the domestic market partially offset the fall.

- **Important increase in automobile fleet,** reducing its age and leading to an inhabitant/vehicle ratio of 3.7, the lowest in the region.

- **We expect moderate growth in automobile sales** in 2013 due to continuing external restrictions and the impact of electoral uncertainty.

- **The automobile fleet (excluding light and heavy utility vehicles) is expected to grow at an annual average of 3.4% in the mid term, below the regional average,** given a relatively more mature market and medium-high income country.

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Closing date: December 27, 2012

1. Summary

2012 will close with a level of sales in the domestic market of around 810,000 units, down 8.4% yoy, mainly because the sector was affected by import and the exchange market restrictions imposed in late 2011. Our estimates for 2012 already included slowing growth in vehicle demand, but the slowdown in GDP and the increase in the interest rate for loans were higher than expected, prompting a stronger deterioration in domestic demand. The weakening in foreign demand, from Brazil in particular, affected production and led to import reductions in order to maintain a balanced trade with the main Mercosur partner and to sustain the trade surplus.

Although demand for vehicles was down against the record levels of 2011, the fall was relatively moderate compared with other previous episodes in Argentina, supported by a certain degree of improvement in accessibility and credit penetration. The exchange restrictions initially prompted a fall in consumer confidence, although the negative impact on durable goods was offset by the lack of alternative options for channeling the flow of savings, given the ban on hoarding foreign currency and the persistent negative real interest rates.

Credit for car purchases continued to rise at rates of around 40% yoy despite the increased financial cost observed during 2012, so 39.1% of total vehicles licensed were acquired with loans. However, the role played by credit in total vehicle sales still remains low when compared with other regional economies (Brazil, Chile and Colombia), given that most transactions are still carried out in cash.

The vehicle fleet continued to grow, bringing the Inhabitant/ Vehicle ratio to 3.7 in 2012, the lowest at regional level. The average age of the car fleet also fell given that the vehicles incorporated over the last five years account for 30.9% of the country's total vehicle fleet.

Dynamism in the automobile sector was weakened by the set of commercial and exchange restrictions established in late 2011/early 2012. We expect growth in vehicle sales of 6.5% yoy in 2013, below what would be expected based on the performance of macroeconomic variables, because the higher level of uncertainty due to the elections and low consumer confidence should offset demand for durables. Although we expect external restrictions to continue, we believe that they will be eased due to higher export proceeds, thus ensuring better supply conditions in the automobile sector.

In the mid term, we expect the rate of growth in the vehicle fleet will slow, in line with slowing growth in GDP per capita. Additionally, in Argentina there is a smaller gap in car ownership compared to developed countries because it is a country with medium-high income with a relatively developed vehicle fleet. Growth in the automobile fleet poses a challenge in terms of the required investments in improving the roads network, and also resolving congestion problems in major urban centers, while improving railway and subway services.

2. Important reduction in production and sales in 2012 due to restrictions in the external sector

Following the sector's boom in 2011 in terms of growth in production, domestic demand (+26.5% yoy) and foreign trade, our estimates for 2012 pointed to a slowdown in the growth in domestic demand for vehicles (10.4% yoy). The decline in the pace of demand growth could be attributed to several factors: a) the lower disposable income of households due to the expected slowdown in economic activity which would have a negative impact on employment and wage growth; b) the impact on household budgets of the increased prices of public services to reduce the level of government subsidies provided to the energy and transport sectors, and c) increases we expected to see in interest rates, which would have an impact on the volume of credit.

However, with the information available to November, total vehicle sales (of both national and foreign origin) are estimated to amount to 810,000 units (-8.4% yoy), significantly lower than expected. This performance can be explained by a sharper slowdown in the Argentinean economy and higher increases in interest rates than originally expected, and also due to a worse than expected economic performance in Brazil, but particularly by the stronger administrative restrictions on imports imposed by the Argentinean government.

As can be seen in Table I, the slump in foreign demand and cancellation of the trade agreement with Mexico midway through the year had a notable impact on exports, which fell over 20% yoy. Imports also declined due to the impact of exchange restrictions and also due to administrative barriers and quotas on vehicle and spare parts imports (for example, the requirements to compensate imports with exports), which mainly affected the high end vehicle market.

Table 1
Automobile Market Situation

	January - November		**Change**
	2012	**2011**	**% yoy**
Production	703,472	776,359	-9.4%
Imports	429,777	504,268	-14.8%
Nationally manufactured car Sales to Domestic Market	311,958	296,227	5.3%
Exports	373,767	471,132	-20.7%

Source: BBVA Research using Adefa data

The fall in foreign demand prompted a downward adjustment in production (-9.4% yoy) as 60% of the vehicles manufactured locally are exported. The negative impact on industrial output was offset by the positive performance in sales of locally manufactured cars to dealers in the domestic market.

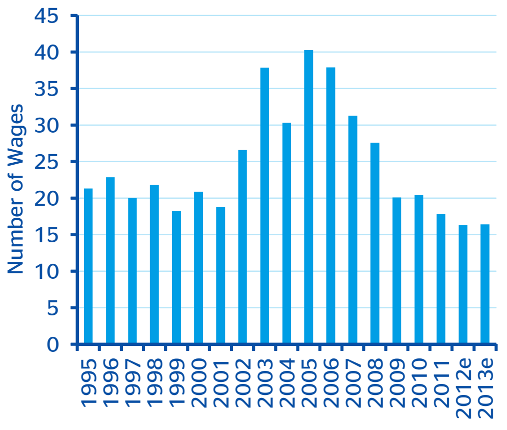
3. The automobile sector was supported by domestic sales

Domestic demand for automobiles remained at relatively high levels in 2012 even though vehicle sales (both imported and locally manufactured) fell 8.4% against the record level the previous year. In the first eleven months of 2012, imports fell 14.8% yoy, while, on the other hand, sales of nationally manufactured vehicles rose 5.3% yoy, so that the fall in total sales would appear to be partly due to supply constraints stemming from low imported vehicle inventories, which account for over 60% of the local supply.

Exchange restrictions imposed in late 2011 initially prompted an increase in uncertainty and a fall in consumer confidence, with a negative impact on demand for durable goods. However, growing restrictions on saving in foreign currency and persistent negative interest rates in real terms eliminated these traditional saving instruments for the higher income sectors. In light of the problems in the real estate sector - due to the "peso-fication" of transactions - the automobile sector appeared as an alternative way of channeling households' surplus cash, helping to fuel the domestic demand for cars.

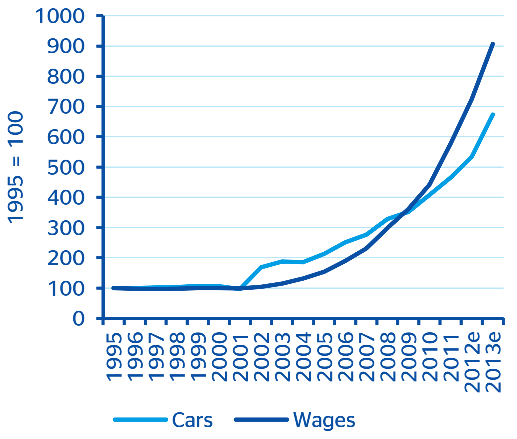
Accessibility conditions also improved slightly during the year, as the wage increases in the formal sector of the economy were significantly above the average increases in vehicle prices. As can be seen in Chart 1, accessibility conditions improved significantly in 2009 and continued to do so in following years, though to a lower extent. Over the last five years, wages of workers in the formal market increased by an average of 24.9% per year, while vehicle prices rose at an annual average of 14.4% (see Chart 2).

Chart 1
Automobile Access (# of monthly wages required to purchase average priced car)



Source: BBVA Research

Chart 2
Automobile Prices and Wages (1995=100)



Source: BBVA Research using Adefa and Indec data

We expect this trend to revert in 2013 resulting in an improvement in relative vehicle prices due to the joint action of several factors. First, greater pressures on prices arising from the external sector, given that imports cover 60% of total demand for vehicles, and that we expect the devaluation pace to increase to around 20.4% yoy in 2013. These pressures would be moderate, however, considering that most of the foreign trade transactions are dominated by transfer prices (as they are intra- company). The devaluation would have to be considerably higher than is expected for it to have an additional impact on prices and therefore on demand for vehicles. In turn, the upturn in demand would limit the discounts on listed prices carried out this year, enabling some degree of improvement in companies' profit margins.

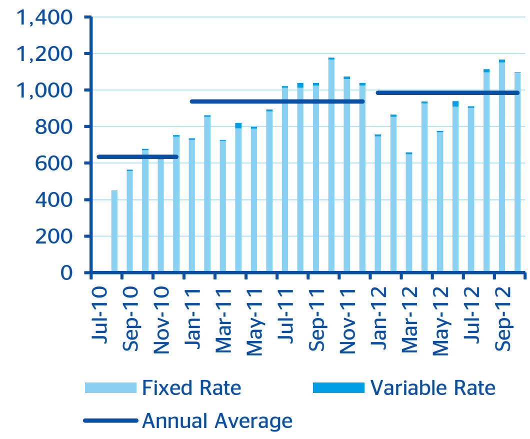
With respect to other cost pressures, our initial estimate of a 25.3% yoy increase in average wages envisages a complicated collective bargaining scenario for the coming year. Although the government has begun negotiations to reach an agreement on prices and wages - which if achieved would limit wage hikes, the guideline being of around 20% yoy - this seems unlikely given that the workers' representatives are divided into different union centrals, promising what would be complex negotiations.

In this scenario, there should be a mild marginal deterioration of the accessibility ratio, but it would continue to remain at some of the lowest levels for the period under analysis (see Chart 1).

4. Gradual increase in car loan participation

Automobile credit was the most dynamic segment of the consumer finance market in 2012, with an average monthly level of $ 1000 million in car loans, and significant growth of 31.1% yoy to November, in line with our estimate of growth in consumer finance. This increase is particularly striking given the large rise in automobile finance the previous year (76.7% yoy) and the fact that it has occurred in a context of rising interest rates. We expect the growth in car loans to pick up slightly next year to 36% because private consumption will be one the most dynamic sectors of the economy in 2013, while the share of vehicles financed with credit instruments should continue to rise gradually.

Chart 3
Total Monthly Car Loans (million pesos)



Source: BBVA Research using BCRA data

Table 2
Vehicle Registration and Car Loan Creditors

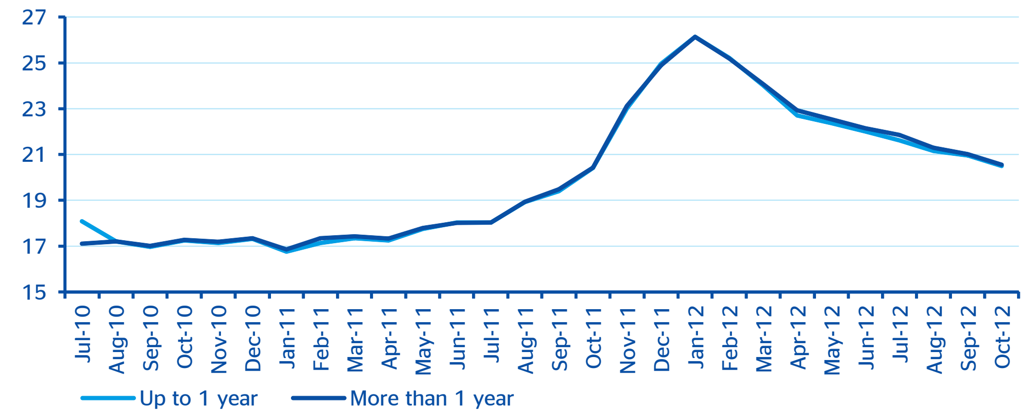
	2011		Jan-Oct 2012	
	units	Share %	units	Share %
Banks	111905	13.0%	86189	11.5%
Automobile Make Financing Agencies	90187	10.5%	86054	11.5%
Savings Plans	105614	12.3%	103251	13.8%
Car Manufacturers	532	0.1%	502	0.1%
Dealerships	6842	0.8%	5872	0.8%
Miscellaneous	13549	1.6%	10549	1.4%
Total financed	328629	38.3%	292417	39.1%
Payment in cash	529354	61.7%	455856	60.9%
Total registrations	857983	100.0%	748273	100.0%

Source: BBVA Research using Adefa and Afima data

However, the role played by financing in total vehicle sales (39.1%) increased only slightly and still remains low when compared with international standards, given that most car purchases are still made in cash. In 2012, the proportion of Automobile Manufacturers Financing and of Savings Plans (see Table II) increased, while the share of bank financing fell.

Interest rates for car loans rose sharply in late 2011 in line with the Badlar rate, and reached a peak in IQ12, after which they gradually fell. However, the average for the first 10 months of 2012 stands at 22.7%, a neutral figure in terms of inflation. Nonetheless, the total cost for the customer, according to market sources, is expected to have increased this year due to the higher administrative expenses, with the total financial costs amounting to 35/40% yoy.

Chart 4
Interest rates of Cars loans creditors (%)



Source: BBVA Research using BCRA data.

5. Few changes in rankings by models

A total of 858,000 vehicles were registered in 2011 (latest annual information available), with an approximate value of USD 24,000m. Cars and light utility vehicles accounted for 95.5% of this total (819,400 units), and the remaining 4.5% were heavy utility trucks and vehicles (386,000 units).

As can be seen in table III, the automobile and light utility vehicle ranking is still dominated by the same brands as in previous years, although there has been a slight increase in the market share of the top five manufacturers (Volkswagen, Chevrolet, Renault, Ford and Fiat) against the previous year (73.7% vs. 71.3%).

The ranking is led by Volkswagen, with 20.9%; its leading models are the Gol, Suram and Bora. Next comes Chevrolet, with 16.3%, with Classic and Aveo being the most popular models.

Table 3
Sale of cars and light utility vehicles to the public by make

		2011		2010	
	Automakers	**units**	**Share %**	**units**	**Share %**
1	Volkswagen	171058	20.9%	125471	19.7%
2	Chevrolet	133378	16.3%	101317	15.9%
3	Renault	105929	12.9%	82376	13.0%
3	Ford	105018	12.8%	77941	12.3%
5	Fiat	88159	10.8%	65784	10.4%
6	Peugeot	74439	9.1%	56034	8.8%
7	Toyota	36502	4.5%	31025	4.9%
8	Citroën	32348	4.0%	23496	3.7%
9	Honda	17493	2.1%	20655	3.3%
10	Nissan	13803	1.7%	10021	1.6%
11	Mercedes Benz	6889	0.8%	6245	1.0%
12	Hyundai	5399	0.7%	5227	0.8%
13	Audi	5217	0.6%	3940	0.6%
14	Chery	4620	0.6%	2496	0.4%
15	Dodge	4117	0.5%	2887	0.5%

Source: BBVA Research using ACARA data.

The top five makes of heavy Utility vehicles account for 85.7% of the total, lower than the corresponding figure for last year of 86.8%. While the same makes continue to dominate the market, in the total there are changes in market shares: there are slight falls in the shares of Mercedes (which continues in the top spot), Ford and Volkswagen, while Iveco and Scania have increased their share.

Table 4
Sale of heavy utility vehicles by make

		2011		2010	
	Automakers	units	Share %	units	Share %
1	Mercedes Benz	8587	32.8%	5958	33.9%
2	Iveco	4662	17.8%	2976	16.9%
3	Ford	4285	16.4%	3226	18.4%
4	Scania	2608	10.0%	1381	7.9%
5	Volkswagen	2272	8.7%	1709	9.7%
6	Agrale	1278	4.9%	897	5.1%
7	Volvo	952	3.6%	392	2.2%
8	Renault	678	2.6%	381	2.2%
9	Puma de Tat	348	1.3%	308	1.8%
10	Hyundai	288	1.1%	268	1.5%

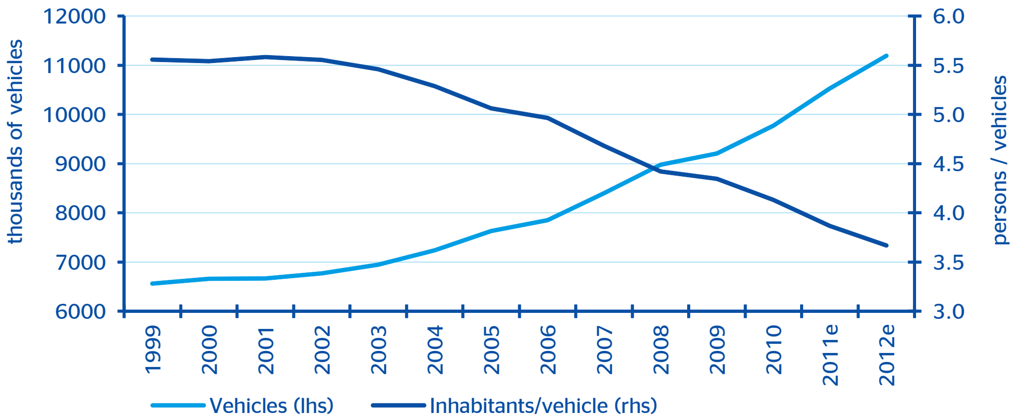
Source: BBVA Research using ACARA data.

6. Significant renewal of automobile fleet

Due to the significant rise in car sales in recent years, there has been a marked growth in Argentina's automobile fleet (including cars, light and heavy utility vehicles), while the age profile has also improved.

According to our estimates, the automobile fleet will have reached 11.2 million cars in 2012, a ratio of 3.7 inhabitants per vehicle, at the forefront of the Latin American ratios. Interestingly, 30.9% of the total automobile fleet was incorporated over the last five years, giving an idea of the large-scale renewal taking place over this period.

Chart 5
Automotive Fleet Growth



Source: BBVA Research based on DNRPA data, and in-house calculations

7. Moderate recovery in 2013

Our economic estimates indicate that following a slump of 8% in 2012, total sales of automobiles (nationally manufactured + imported) should recover in 2013. Thus, using a simple single equation economic model to relate, on a quarterly basis, total automobile sales with (1) the interest rate for car loans, (2) the rate of growth of GDP per capita, (3) the average price of automobiles, and using our projections for these 3 variables (growth in GDP per capita of 2.3% yoy in 2013, a slight rise of 1pp in the rates on car loans which, however would become more negative in real terms, as inflation would rise even more and the price assumptions indicated above) the model forecasts total sales to rise 10.5% y/y in 2013 to 886,300 units sold, 0.3% higher than the record sales figure for 2011..

However, taking into account variables not included in the model, we have reduced the level of expected sales increase to 6.5% yoy, bringing the number of units sold in 2013 to 862,650. Factors weighing down on car sales will be the greater uncertainty associated to the electoral process in 2H13, consumer confidence remaining at low levels, and possible administrative restrictions on imports, though not to the same degree as in 2012, as we expect there to be a scenario of greater availability of foreign currency due to the rebound in agricultural exports.

In this scenario, the total vehicles sold in 2013 would still be 2% below total sales in 2011 and also well below the 936,000 in automobile sales which we expected for 2012 at the end of 2011. Thus, the commercial and exchange restrictions implemented in late 2011/early 2012 curbed growth in the auto sector and dampened market dynamics.

Bearing in mind that imports represent 60% of total sales (according to the average for the last five years), we expect local production to grow at 3.5 % yoy to 794,500 units, supported both by local demand and also by exports, which would increase around 11.2% yoy to reach 453,500 units. External demand would be spurred by Brazil, which accounts for the largest share of Argentinean automobile exports, since the economy is expected to expand by 4% in 2013, and the elasticity in demand for automobiles to GDP has remained at 2.6 in the past decade. Furthermore, a new agreement with Mexico might be signed to replace the one suspended last June. Press sources indicate that the two national automobile chambers have reached an agreement which would shortly be approved by the national authorities. By virtue of this agreement, there would be rising quotas of Mexican car imports until 2015, when trade would be completely freed. As in the case of Brazil, commercial transactions in vehicles between the two countries on both the Mexican and the Argentinean side would be exempted from external zone levy (the Mercosur extra-zone tariff amounts to 35%). Argentinean imports of Mexican automobiles were in the region of USD 900 million in 2011 but in the new agreement, the quota would be lowered by 30%/35% to approximately USD 600 million in 2013.

Box 1. In the mid term, the automobile fleet grows below its regional average

The rapid growth in the vehicle fleet is not a purely Argentinean phenomenon, but is in fact evident in other emerging markets with high population density and steady economic growth. In fact, over the last decade, the vehicle fleet of EAGLE countries was increased by 1.5 times, while Argentina's did so by 0.5[1]. In Asian countries, the fleet increased by 2.3 times due to the strong growth in China, India and Indonesia. At the same time, vehicle demand in developed countries has run out of steam, leading to a significant decline in sales, due to the international financial crisis which began at the end of the last decade.

In this context, BBVA Research has estimated the growth in the vehicle fleets of different emerging markets in coming years; these countries will play a leading role in developing the automobile market.[2]

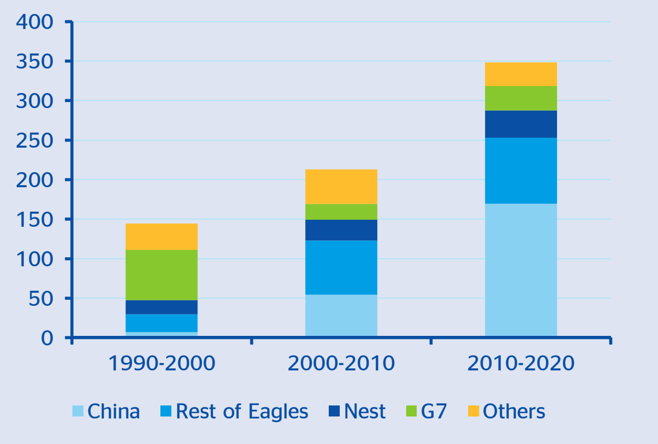
For that purpose, a long term panel model was estimated to assess changes in the number of vehicles per thousand inhabitants, as a function of income per capita, degree of urbanization, population density, financial depth and the quality of road infrastructure. The core model makes use of a non-linear relationship called the Gompertz curve, which associates car ownership levels with income per capita.

The idea behind this relationship is that the car per inhabitant ratio is very low at very low levels of income per capita; however, it takes off at medium-low income levels, and grows very rapidly so as to reach certain saturation levels at high income levels.

According to this model, strong and sustained economic growth will fuel vehicle demand in emerging markets (see chart 6). In Latin America, Turkey and the rest of Asia, demographics will also be a very important factor. Thus, the Chinese vehicle fleet is expected to increase fourfold over the present decade to become the world's largest. Brazil's fleet is expected to reach the size of Japan's, while Russia and India edge closer to that level, leaving the rest of the G6 countries behind. Developed countries, on the other hand, stand close to saturation levels both in terms of income per capita and demographics, except for the United States. Sales in these countries will depend on amortization and technological breakthroughs.

Chart 6

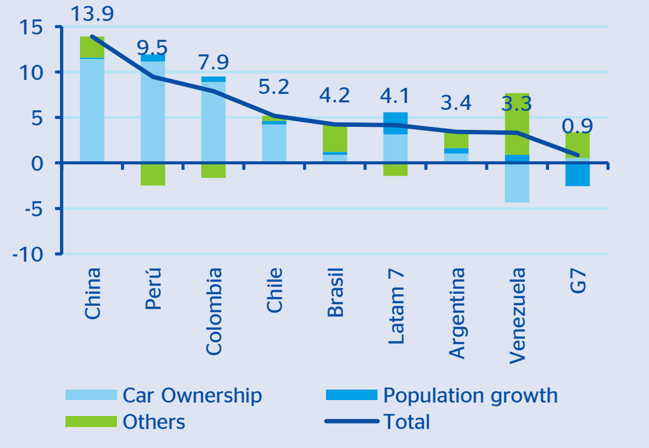
Increases in World Vehicle Fleet, by decades (millions)



Source: BBVA Research

Chart 7

Growth in Vehicle Fleet in 2010-2010 (pp, by components)



Source: BBVA Research

1: The term EAGLE (acronym for Emerging and growth-leading economies) has been coined by BBVA Research to refer to economies which will play an important role in world growth over the next ten years. The group currently consists of the following countries: Brazil, China, India, Indonesia, South Korea, Mexico, Russia and Turkey. There is another group of companies which would deserve this name in the future, and which are now included in what is called the Nest group, made up of Argentina, Bangladesh, Chile, Colombia, Egypt, Malaysia, Nigeria, Pakistan, Peru, the Philippines, Poland, South Africa, Thailand, Ukraine and Vietnam. For further information on the EAGLE countries see: http://www.bbvaresearch.com/KETD/ketd/esp/nav/geograficas/eagles/index.jsp

2: For further details of the model and the result, see the BBVA Research Economic Watch report "The key emerging markets for the automobile sector", http://www.bbvaresearch.com/KETD/fbin/mult/121010_EAGLEs_Auto_Projections_ES_tcm346-359405.pdf?ts=26112012

In Argentina's case, as it is a country with medium-high income per capita, which has a relatively developed automobile fleet, expected growth for the decade stands below the regional average. According to Chart 7, growth would average 3.4% per annum. Therefore, with an automobile fleet of 8.2 million units in 2010, the figure would increase to 11.4 million by 2020. This higher level of saturation in the new automobile segment could give rise to an interesting business niche in the used car market.

However, it is important to take into account that growing automobile fleet numbers will also require greater road infrastructure, in order to prevent congestion problems and their associated costs. Argentina's primary road network - the national highways - is extensive (39,398.7 km) and most of it is paved. However, in the secondary and tertiary networks (provincial and municipal), which amount to 450,000 km, the share of paved roads falls sharply and there are signs of deterioration in maintenance. The World Economic Forum's Executive Opinion Survey assigns a rating of 3 to road quality (rating from 1 = extremely undeveloped and 7 = extensive and efficient). It is also important to note that other countries in the region such as Chile (5.6), Ecuador (4.4), and Uruguay (3.6) are clearly in a better position. Additionally, there are congestion problems in major urban centers such as Buenos Aires, Córdoba and Rosario, implying that new urban access highways and improvements in public transport will be needed.

Sustained growth in the automobile fleet will pose important challenges in terms of road investment in Argentina over this decade, while it will also be necessary to improve railway and subway services, which have deteriorated greatly in recent years.

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