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Automobile Market Outlook

Panama

2011
Economic Analysis

- **Sales of vehicles in Panama reach historic levels in 2011. We estimate sales approaching 47,000 units next year,** a large proportion of which will be commercial vehicles.
- **Free Trade Agreement with the United States poised to favor supply of new cars** and, consequently, the modernization of the vehicle fleet.
- **Low interest rates will increase access to credit over the coming years,** incentivizing a greater role for bank financing in the purchase of cars.

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Closing date: December 15, 2011

1. Introduction

Panama's economy grew 10.4% year-on-year to September, boosted by a high level of both public and private investment in construction and infrastructure. This improvement has corresponded to a marked increase in the sale of vehicles, in line with the dynamism indicated by other household spending indicators. In fact, expected sales in 2011 (around 45,000 units) will exceed the forecast of 42,000 in our previous report, which set the bar high compared to other estimates for the sector.

The Panamanian automotive supply, which comes from abroad, reflected this demand behavior. While in 2010 the FOB value of imports (chapter 87) grew 12% year on year, as of June 2011, purchases of transport equipment increased over 50% year-on-year.

The prospects of the automotive sector in Panama are positive, supported mainly by the expected growth of GDP per capita over the coming years, continuing low prices, and the stability of interest rates.

2. Current situation and outlook for the automotive industry

Automotive industry sales meet expectations

Automobile sales reached 41,781 units in November of 2011, 23.4% higher than the same period in 2010. Thirty-eight percent of the total purchases (data up to October) corresponded to private cars, a proportion which increased compared to last year's 35%. The opposite occurred with SUV sales, which represented 36% in 2010 compared to 31% in 2011.

The change in the composition of sales is closely linked to the increase in the domestic price of fuel, which led households to purchase smaller cars. For instance, between May 2010 and May 2011, 95 octane gas rose from US$3.33 to US$4.46, a level close to the historic maximum of US$4.50 in July 2008.

Over the last months the price of fuels has dropped, but the demand for small cars will be sustained due to the entry into the labor force of new young professionals whose average salary is not much higher to the threshold for buying a car. For its part, demand for larger horsepower cars will continue to be strong due to the higher standard of living of Panamanians already in the work force and due to better equipment of roads for inter-city transport.

This year sales are poised to reach around 45,000 units, above the 42,000 units forecast by BBVA Research in April for the average of transactions between 2011 and 2014. The result seen leads us to make an upward revision of our forecast for 2012 to a level higher than 47,000 units (5% year-on-year increase), given that the growth surprise could spillover into the coming years.

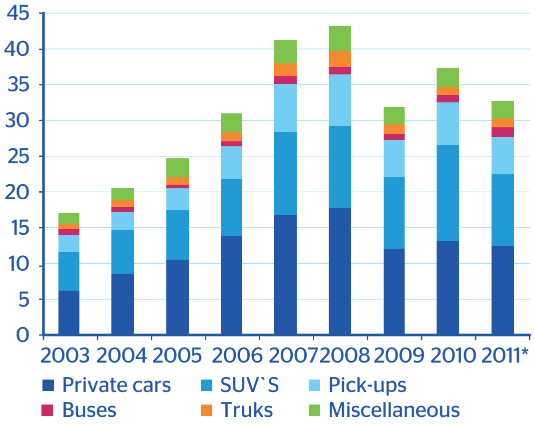
Furthermore, the unemployment rate dropped in 2011 by about 2 percentage points to 4.5%, surprising market consensus, which expected reductions to 5.5% on average upon year's end. The current unemployment rate in Panama is very close to its long-term level so in spite of the fact that additional reductions in 2012 will be marginal (up to 4.2% according to our calculations), it will remain within levels supporting an important increase in the quantity and quality of employment, with a corresponding better behavior of salaries.

Still, we are making a conservative revision taking into account the possible moderation in growth in the context of greater global uncertainty and the effect of mass transport systems on the demand for private cars.

Other factors that will continue to support the increase of automobile sales in Panama are the expected growth of the average income of the population, close to 6% annually in real terms, the increase in good quality infrastructures (the extension of the canal and improvements in national roads), and the demand in transport services in a climate of economic growth. Furthermore, it is hoped that the arrival on the scene of multinational companies (60 were recorded between 2010 and 2011) and the strengthening of traditional companies will continue as the Panamanian economy keeps on its path of rapid growth.

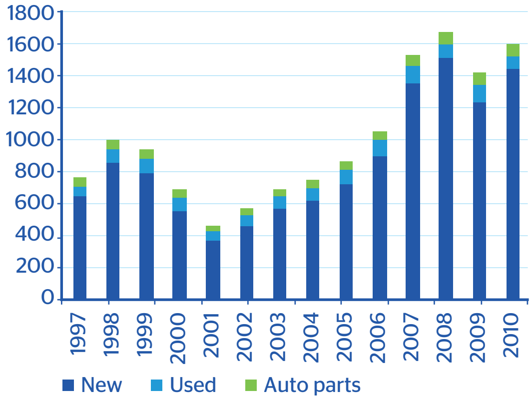
The auto parts industry will take advantage of this greater dynamism in auto sales as long as it has been able to design an integrated service offer suited to new car sales. Furthermore, prospects for prices and quantities are positive with the entry into vigor of the free trade agreement with the United States, the main source of lubricants and other components, and with the extension of the Panama Canal, which will convert the Colón Free Trade Zone in an important supplier for the entire Latin American region.

Chart 1
Sales of new cars in Panama (thousands of units)



*This year through September
Source: INEC, ADAP and BBVA Research

Chart 2
Automotive sector imports (millions of USD FOB)



*This year through June
Source: INEC and BBVA Research

The offer continues to diversify

The entire automotive offer in Panama is imported. Automobile imports in the first quarter of 2011 rose to US$519.4 million, a figure that compares favorably with the US$863.5 million sold in the whole of 2010. According to these figures, in spite of the reduced offer caused by the disruption in production lines following the earthquake in Japan, lower international vehicle prices (both new and used) have supported the demand for cars in Panama.

New cars have increased their share of total imports over recent years. While they represented 81% of the total in 2000, they corresponded to 90% in 2010. This demonstrates that restrictions to internal used car dealing have had positive impacts on the renewal of the Panamanian automotive fleet.

Penetration by the different vehicle brands in the market has experienced small variations. In 2010 Toyota was in a leading position with 23% of the market and it is now in second place with 20%, behind Hyundai, which slightly increased its market share for the year in course from 20% to 21%. Furthermore, the positive evolution of the KIA brand should be noted, as it has gone from 9% to 11% of current sales. In general, during 2011, brands with offers in Panama specialized in the sale of fuel efficient cars.

Over coming years, the establishment of fuel price caps by Panama's government and the expected stability of oil prices could mean that larger cars recapture market share.

Furthermore, it is expected that Chinese cars will continue to gain market share, given their competitiveness in prices and the greater market confidence that they have acquired, in keeping with the trend for the entire region. Also, the trade treaty entered into with the United States, as we shall see in the next section, will increase Panama's access to imported cars from this country.

Automotive parts imports had reached US$43 as of June 2011, which compares favorably with the value of US$81 million for the whole of 2010. The boost to the sector will come from the service centers' capacity to better integrate their sale and repair offers, as well as by the greater volume of car sales expected on the medium term.

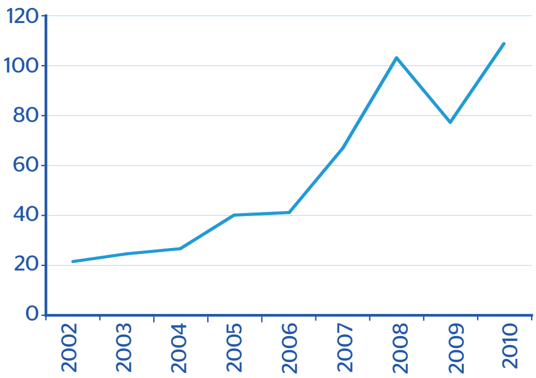
3. Commercial agreements and tariffs

The free trade agreement with the US will facilitate new car purchases

The free trade agreement between Panama and the US was ratified in October by the US Congress. The US is the main social partner of the country, a relationship that could deepen following the entry into vigor of the treaty and the extension of the Panama Canal.

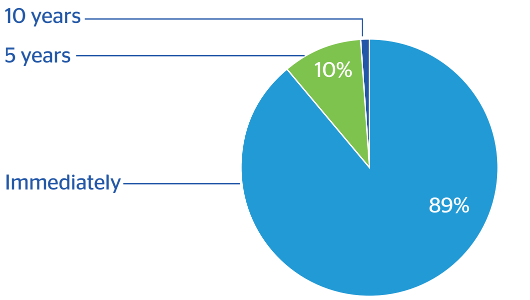
Panama is a net importer of vehicles from the US and maintains an average tariff of 12.7% on cars from that country, with a range between 5% and 20% depending on value. For passenger cars tariffs vary between 10% and 20% (15% for cars costing between US$0.00 and US$12,000; 18% between US$12,001 and US$14,500 and 20% for those costing over US$14,500), vans are subject to a tariff of 10% and for trucks it varies between 5% and 10% depending on the weight.

Chart 3
Imports of new and used passenger cars from the US to Panama (in millions of US$, FOB)



Source: US Census Bureau

Chart 4
Schedule for import tariff reductions on vehicles and auto parts under the FTA with the US



Source: US Department of Comme

The agreement will immediately eliminate tariffs on 89% of car and auto parts imports from the US, with the elimination of tariffs to be spread over 10 years for the remaining imports (see chart 4). In particular, 78% of vehicles and 96% of parts will become tariff free immediately, 3% of imported vehicles will become tariff free in five years, and the remaining 19% of vehicles and 4% of parts will do so in ten years.

The tariff structure has incentivized the import of used vehicles due to their lower import prices and consequent lower tariffs. The agreement should eliminate this distortion, also making it possible for Panama to impose restrictions before the entry into vigor of the agreement to control the import of used vehicles. Therefore we can expect a restructuring of the automotive fleet in Panama, with greater willingness on the part of households to buy new as opposed to used cars, which currently amount to almost 50% of the cars imported from the US.

4. Financing

The total balance of vehicular sales in September of this year was US$656 million, with a nominal growth of 8.0% year-on-year. Its share of total consumption remained stable at 12%, while its share of total credit was reduced from 3% at the start of 2010 to the current 2% due to the very significant increase in the commercial sector (27% y/y on average).

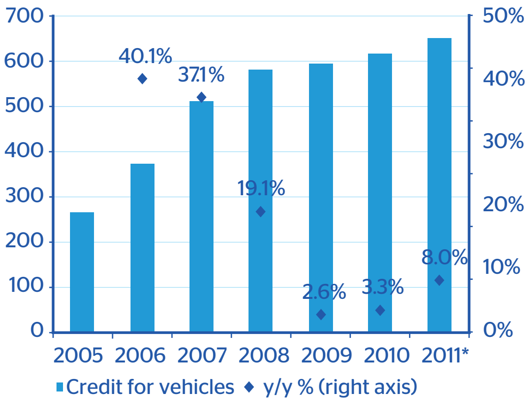
The average interest rate for cars in the Panamanian system continues on a downward trend, although at a slowing pace in recent months, having reached a nominal rate of around 7.6%. It is expected that, in keeping with the prolonged international low interest rates scenario, car loan interest rates will remain in the 8%-9% interval, with the consequence that they will continue to increase household debt. In fact, as of August this year, the number of new credits for this purpose grew 25%, with the average value of vehicles financed remaining stable around US$16 million.

As of August, the Panamanian banking system had financed less than 38% of new car purchases in the country, a figure similar to 2010, but lower than 2008, when around 46% was financed through banks. The remaining source of financing comes from the dealers themselves and buyer savings, but, based on available statistics, it is not possible to estimate the value of each type of financing. Calculations by the Auto Distributors' Association of Panama show that, in last October's "Exposhow", 65% of sales had taken place through banks and 35% directly with dealers.

The most common repayment periods are between 49 and 84 months, with these types of loans making up 85% of the total amount extended out in 2011. Among these, 45% of the total is from loans repayable in six and seven years.

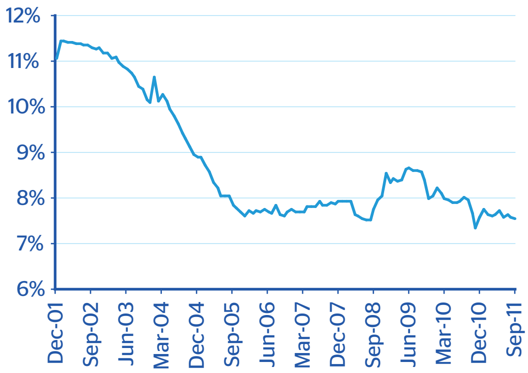
Opportunity for growth in auto financing is extensive given the increasing proportion of new vehicles over recent years. This affords the financing system more favorable conditions to enter the market, considering that new cars may present better financing conditions in rate and repayment period due to the lower risk that they represent. Furthermore, we expect that low interest rates will incentivize the demand for credit and make it possible for new professionals entering the labor market to afford the purchase of their first vehicle.

Chart 5
Balance of car credit (US$ millions)



*This year through September
Source: APC, INEC and BBVA Research

Chart 6
Interest rate for car financing



Source:APC, INEC y and BBVA Research

5. Conclusions

Advances in the public infrastructures plan over recent years have meant better inter-city roads that, including in the short term, have resulted in improvements in the connections between the provinces and Panama City, compensating for the negative effect of the fuel price rise on the purchase of higher horsepower vehicles.

Over the coming years, the optimization of mass transit systems could moderate auto purchases for the purpose of inner city commuting, although the commercial and private sector strength will be maintained for commutes between towns and toward the canal. In fact, the extension of the Panama Canal will result in a significant increase in the export of commercial services and in the generation of currency for the economy that will support the increase in domestic demand. Furthermore, the automotive body and motor parts sector will capitalize on the greater demand for heavy load and public transport vehicles to increase its business volume.

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