BBVA Research

Latin America

Automobile Market Outlook

December 2010

Economic Analysis

- The automobile sector expanded rapidly in 2010 in response to strong domestic demand.
- Sales will continue to grow over the next two years at around 15% p.a. The number of new vehicles sold should exceed 6.5 million in 2012.
- The reasons for this rapid expansion include the strength of domestic demand (in particular, consumption), low finance costs, exchange rate appreciation and progress on tariff reductions related to trade agreements.
- The region's vehicle fleet is still small, even compared to countries with similar levels of development. This suggests that the expansive cycle will be maintained for a few more years.
- Furthermore, growth in the region will result in a rapid increase in the relatively young middle class, and this will provide an additional impulse to automobile sales.
- A slowdown in economic growth would temporarily moderate these sales forecasts, but the long-term trend will remain unchanged.

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Closing date: 7 December 2010

1. International perspective

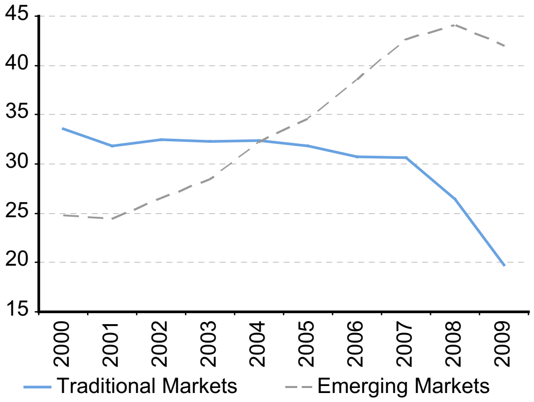
The automobile sector is key in most large economies, whether developed or developing. It is a source of major innovations and can radically transform a large number of manufacturing processes, as well as providing a major market for a wide range of industries that depend on vehicle manufacture (steel, aluminum, glass, plastic, rubber, electronics and textiles, etc).

As ECLAC explained in its latest report on Foreign Direct investment in Latin America and the Caribbean, the automobile sector has not been immune to the current process of globalization, and this has changed some of the key patterns in the industry. There has a surge in the process of delocalization of production from the main developed countries to a select group of emerging economies (Chart 1) that combine large domestic markets with lower production costs and proximity to major export markets. The biggest surge has been in the BRIC countries (Brazil, Russia, India and China) which, together with South Korea, Mexico and some new members of the European Union (Slovakia, Poland and the Czech Republic), are starting to consolidate their positions as the new production centers for the industry.

It is also worth noting that the inflow of foreign direct investment and the international expansion of many transnational companies have played such a major role that some of these economies (Japan, South Korea and, more recently, China) have become important locations for the automakers' integrated international production systems that dominate global vehicle production. This has intensified competition on brands, innovation and finance between the main automakers and challenged the supremacy of U.S. and European manufacturers.

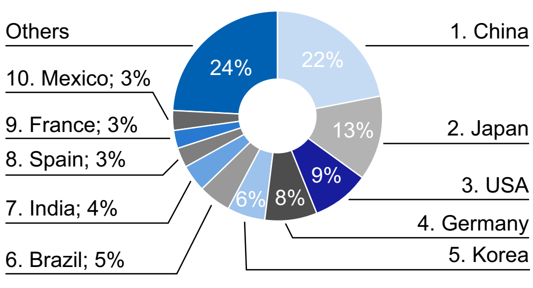
Over 90% of production in Latin America is in Brazil and Mexico, which are in sixth and tenth place respectively at the global level (Chart 2). The competitiveness of the Brazilian automobile industry is based on specialization in compact vehicles, strong domestic demand and complementary production and trade ties with Argentina. These elements, together with an aggressive policy of support and tax incentives, enabled the industry to recover rapidly from the recent crisis. México has consolidated its position as an exporter of medium and large vehicles, of which 80% were exported in 2009. Mexico's automobile industry is heavily dependent on the U.S. market, which makes it very vulnerable to foreign demand and gave it very little freedom to respond during the crisis.

Chart 1
World Motor Vehicle Production(million vehicles)



Source: International Organization of Motor Vehicle Manufacturers (OICA)

Chart 2
World Motor Vehicle Production (2009, % of total production)



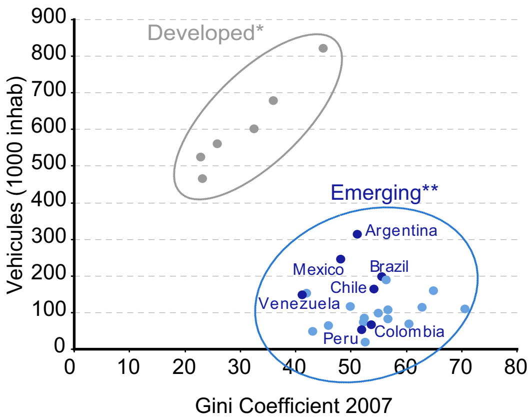
Source: International Organization of Motor Vehicle Manufacturers (OICA)

2. The size of the automobile sector

Latin America is a major automobile market, including large regional players such as Mexico and Brazil and countries such as Argentina that are in the second rank.

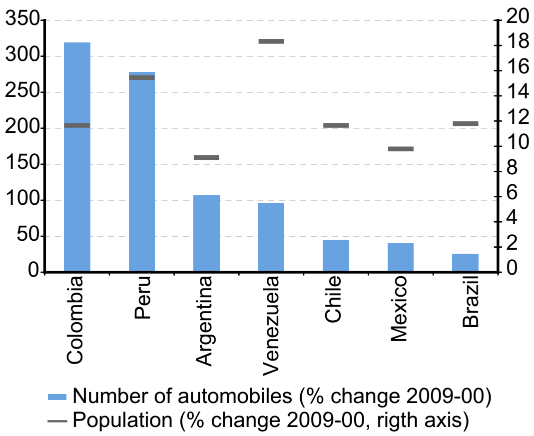
The region has a population of 400 million people. Its GDP per capita increased from USD 3,160 per year in 1980 to USD 7,786 per year in 2009. The IMF reckons that GDP per capita will reach USD 10,770 per year in 2015. This should lead to a major expansion in the automobile market, particularly given the weaknesses of the railroad and urban mass-transit systems (subway systems, buses, etc.).

Chart 3
The size of the region



* Developed: U.S., Italy, Spain, Finland, Sweden and Denmark.
** Emerging: Argentina, Mexico, Brazil, Panama, Chile, South Africa, Costa Rica, Venezuela, Guatemala, Botswana, Namibia, Zimbabwe, Honduras, El Salvador, Paraguay, Hong Kong, Bolivia, Colombia, Ecuador, Peru, Nicaragua and Zambia
Source: WDI

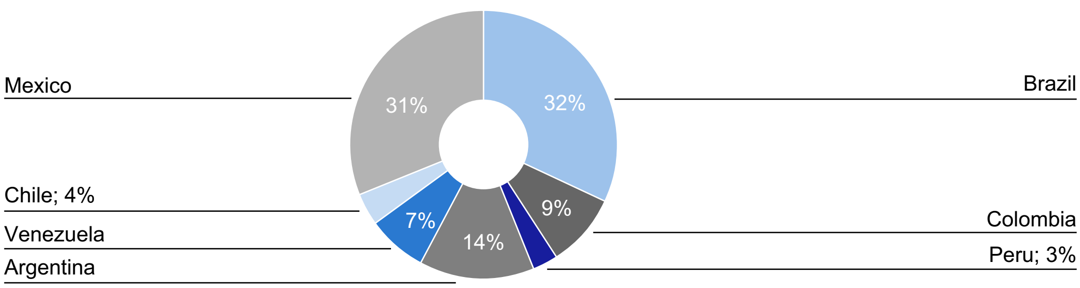
Chart 4
Number of cars and the population (% change 2000-2009)



Source: various sources

The number of vehicles has been increasing rapidly since 2000, rising from 42.1 million to 65.9 million in 2009. Most of them are in Brazil (21 million), Mexico (21 million) and Argentina (9 million).

Chart 5
Distribution of vehicles in the region (% of total number of vehicles in 2009)

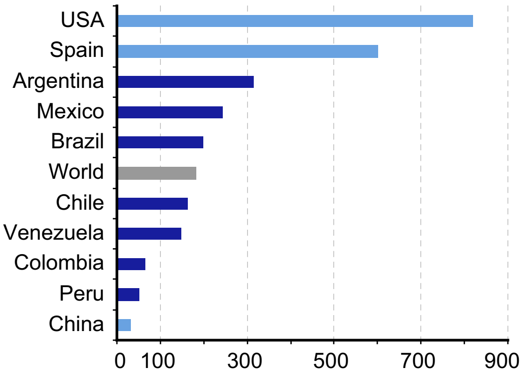


Source: BBVA Research

There was also a significant increase in relative terms. The average number of vehicles per person in Latin America was 169 per 1,000 inhabitants in 2007, a significant increase of almost 50% on the 113 vehicles in 2002. This rate of growth is far higher than in the Euro zone (2.6%), North America (2.9%) or the Asia Pacific region (20%) over the last 5 years.

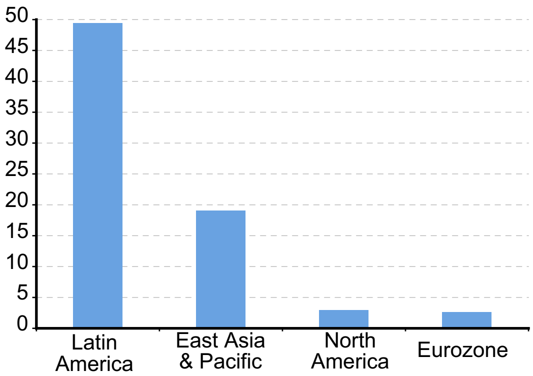
The highest rates of vehicle ownership are in Argentina (6.3 people per vehicle) and Mexico (5.2), whilst Peru has the lowest rate at 16 people per vehicle. These figures compare poorly with 2 people per vehicle in Spain and 1.3 in the U.S.

Chart 6
Automobile per capita in 2007 (vehicles per 1,000 people)



Source: World Development Indicators

Chart 7
Changes in automobile per capita (% chge 2002-2007, vehicles per 1000 people)



Source: industriaautomotrizdevenezuela.com

The average age of the region's vehicle fleet is around 14 years, compared to nearly 10 years in Spain and the United States.

Some 83.5% (2009) of the population of Latin America live in large cities. As a result, the largest numbers of vehicles are also heavily concentrated in these cities. Examples of this include Lima, where two thirds of all the vehicles in Peru are to be found; Buenos Aires province, with half of all the vehicles in Argentina; and Caracas, home to 38% of the vehicles in Venezuela.

In terms of automakers, Chevrolet is the leader in the region, with market share of around 25%: it is particularly strong in Venezuela (under the General Motors brand) where it accounts for 44% of all vehicles sold; Colombia, at 34%; and Chile, at 17%. Below Chevrolet in the rankings are Renault, Hyundai and Kia.

To sum up, the initial conditions of the region's automobile market, i.e., its relatively small size in some countries, the age of the vehicles, and its high level of geographical concentration, suggest that there may be good opportunities for growth if supply and demand factors are favorable over the coming years.

3. Expansion of the automobile sector

Latin America experienced a major expansion in vehicle sales from 2003 to 2007, due to rapidly rising demand on the back of economic growth, and the reduction of import tariffs in some cases (e.g. Peru). These factors led to an 85% increase in sales between 2003 and 2008, when they reached an all-time high of over 5 million.

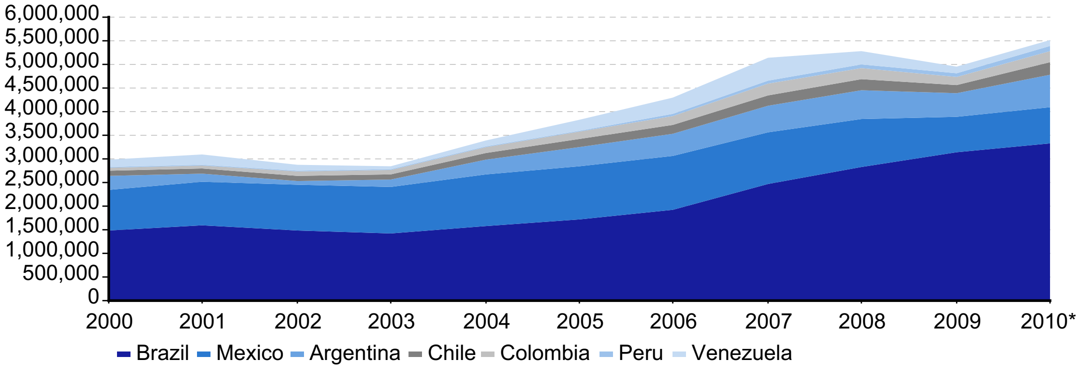
In 2009 the automobile sector was affected by the general economic slowdown and exchange rate conditions. As a result, the number of vehicles sold fell 6% on the 2008 figure. However, it should be noted that this fall was concentrated in Mexico (sales down 26%), due to its strong ties to the United States, and Venezuela (50% down), due to its difficulties in financing any kinds of imports, which led to the government being particularly strict in authorizing currency sales for this purpose.

Recent figures show that there has been a swift recovery. This year, 4 million vehicles had already been sold by September, and it is expected that total sales in the year will exceed 5.5 million units, an increase of over 10% on 2009.

Despite the major growth in the industry since 2003, it still has idle capacity, with an average 65% utilization rate of installed capacity, below the general average of 75% for manufacturing industry.

Chart 8

Vehicle sales in the region (units)



* 2010: Sales extrapolated from data to September 2010.
Source: BBVA Research

4. Determinants of supply

After the stagnation in the sector in 2002 and 2003, the supply of vehicles began a sustained process of recovery. This was interrupted in 2009 by the impact of the international crisis, which affected both domestic production and imports.

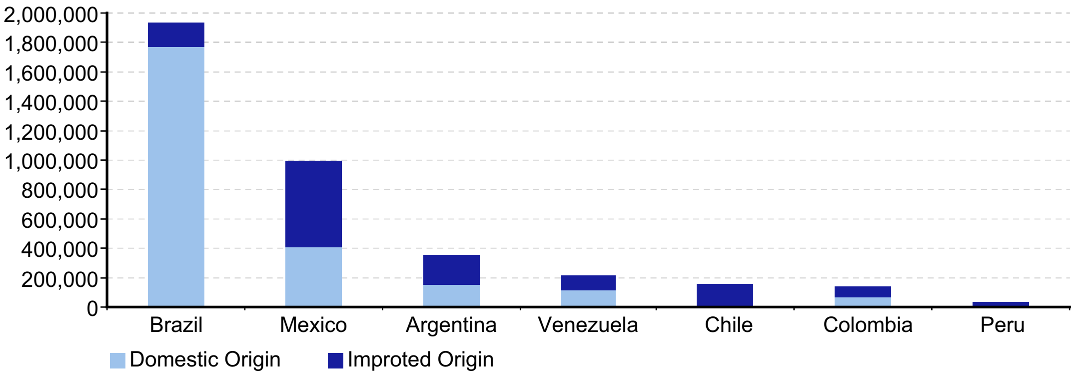
The region can be divided into three large groups of countries: the first group consists of Brazil, the leading producer nation which consumes a large percentage of the vehicles it manufactures; the second group consists of countries such as Argentina, Colombia, Mexico and Venezuela, which are also major manufacturers that export part of their output, but which require substantial vehicle imports to meet domestic demand; the final group are countries such as Chile and Peru, which import all their vehicles.

The Brazilian market deserves special attention. The Brazilian automobile sector has been experiencing unprecedented sales growth. In 2009, the country broke the barrier of 3 million vehicles sold, and sales in 2010 are expected to reach 3.4 million units. These figures mean that Brazil will soon be the fourth biggest vehicle consumer in the world. This was in fact the already case over the first five months of this year, when Brazil sold more vehicles than Germany or Korea, behind only China, the United States and Japan.

Imports play an important role in the development of the automobile sector in Latin America. As can be seen from Chart 9, the region imports approximately 60% of the vehicles it sells, with extreme cases such as Chile and Peru where the figure is 100%. In both these cases, the main source countries are in Asia. Korea was responsible for 34% of total Chilean imports in 2009 (29% in 2008), having recently overtaken Japan (21%) which had previously been the main exporter to the country. One key factor in this situation is exchange rate movements between the countries in the region and the exporters of new vehicles. The depreciation of the dollar against the yen (25% between January 2008 and September 2010) has made Japanese exports less competitive compared with other manufacturing countries, in particular Korea (in the same period the won depreciated by approximately 21% against the dollar). Japan and Korea were responsible for 38% and 22% of total exports to Peru, respectively. China is the third Asian country with substantial growth in vehicle exports to the region. Its market share is still low due to its recent entry into the market (7% in Chile and 4% in Peru), but it is growing rapidly and the low prices they offer are putting China in a position to be a major exporter to Latin America.

Chart 9

Vehicle supply (average 2002-2009) (units sold)



Source: BBVA Research

5. Determinants of demand

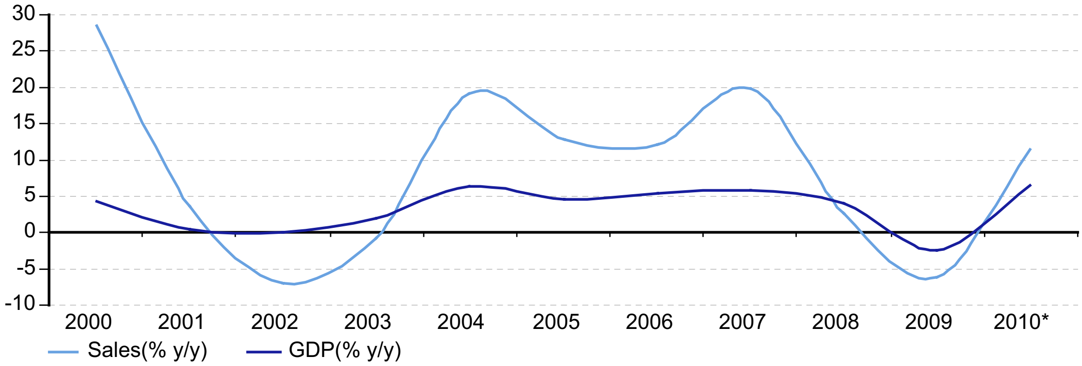
As they are durable goods, vehicles demand is influenced by future expectations of economic performance as well as improvements in per capita income and other factors. As lower unemployment and improvements in real income for workers increase affordability, consumer expectations of whether these changes are temporary or permanent play an important role.

Chart 10 shows that car sales tend to accentuate the cycle. Average GDP elasticity was in the region of 2.9 in the last growth cycle of 2000-2009, with a correlation of 80% over the period. Elasticity in Peru, Argentina and Colombia, was over 3.5.

In the case of 2010, in addition to improved expectations of economic growth, other factors such as higher inflation and lower interest rates have created a disincentive to saving and boosted demand for cars. We expect sales for 2010 in the sector to increase by 10% on 2009, to over 5.5 million vehicles.

Chart 10

Automobile Sector Sales vs. Economic Growth (%)



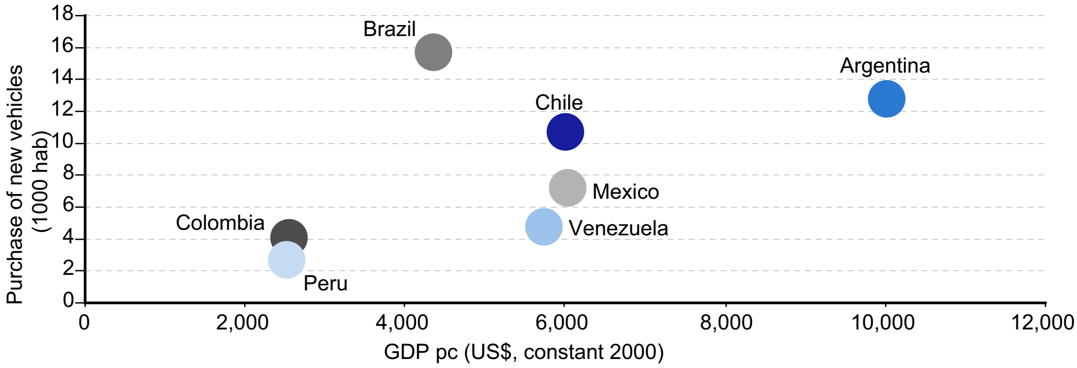
* 2010: Sales and GDP extrapolated from data to September 2010
Source: BBVA Research

In addition to economic growth, a second factor which is underpinning the upward trend in vehicle demand is the large number of households that are breaking through the income threshold to become part of the middle classes. This improves their access to finance and gives them the purchasing power to buy their first vehicle. It is estimated that over the coming years, the middle classes in Latin America will grow by 48% from 74.1 million people in 2010 to 109.8 million in 2010. Economic growth and increased employment, in addition to increasing numbers of women joining the labor market (thus increasing the number of wage earners per household), have thus expanded the potential market for vehicle sales.

As economic growth is expected to increase at an average annual rate of nearly 5% over the coming years, with increasing household income and a larger number of households in higher income brackets, new vehicle sales can be expected to continue to support the strong performance of the motor vehicle sector. This expansion will not be restricted to cars, demand for which is more closely linked to private consumption; it will also include freight and commercial vehicles requiring larger investment.

A third factor that has supported the recent growth of the sector has been lower prices. These have been the result of competition from entry of lower cost brands, such as those from China, and lower import tariffs, partly due to trade agreements. This has been accompanied by the appreciation in local currencies. The average price of a car in the region is around €13,000, with Argentina (€20,000) and Chile (€7,500) having the highest and lowest prices respectively.

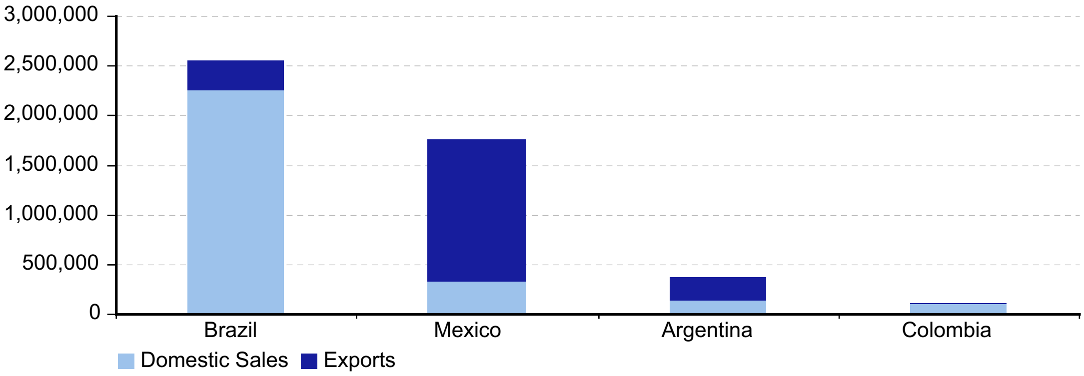
Chart 11
Higher income vs. new car purchases



Source: Alada, World Bank and BBVA Research

With the integration of the sector into the international market, exports have become an important component in demand, particularly in the case of Argentina and Mexico, where exports represent 63% and 81% of total production respectively.

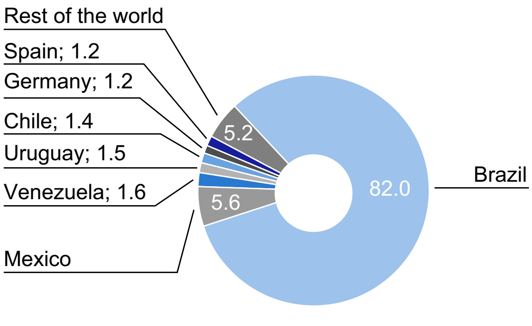
Chart 12
Motor vehicle demand (average 2002-2009) (units produced)



Source: BBVA Research

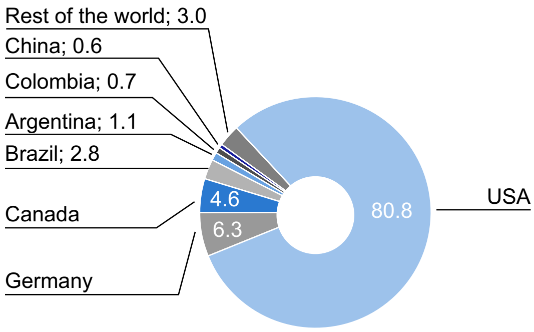
The main destinations for these exports are Brazil and Mexico in the case of Argentina, and the United States and Germany in the case of Mexico. Both countries also export to a lesser extent to other Latin American and European countries.

Chart 13
Argentina: Vehicle exports (2009, % of total exports)



Source: United Nations and BBVA Research

Chart 14
México: Vehicle exports (2009, % of total exports)



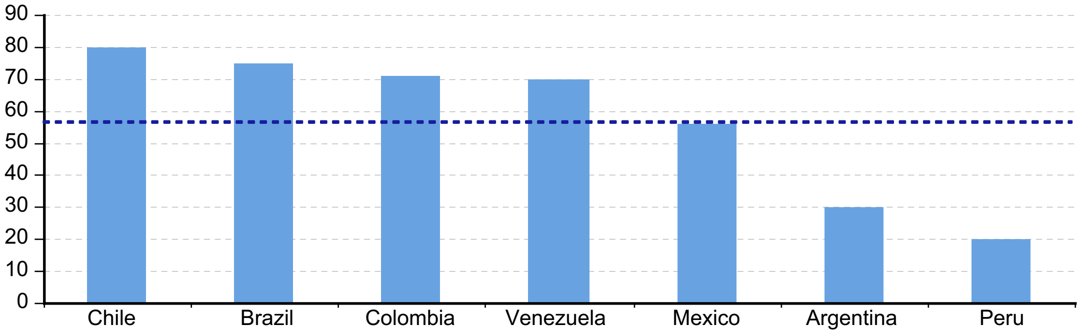
Source: United Nations and BBVA Research

6. Finance

Vehicle acquisition through the use of finance varies throughout the region. The percentage of vehicles financed is around 57% on average, with the extremes being Chile, where 80% of vehicle purchases are financed, and Peru, where the figure is only 20%.

Chart 15

Vehicle finance (% of total vehicles sales using finance)



Source: BBVA Research

The main finance channel for new vehicle purchases is bank lending, which accounts for almost 50% (examples include Chile, Mexico and Venezuela). Finance companies linked to automakers are direct competition for the banks, being involved in around 30% of sales, as is the case in Chile and Argentina. In Colombia, the most common form of finance is based on agreements between financial institutions and dealers. The various financial institutions having a sales presence at the dealers, making the provision of financial services more responsive and making the whole process of buying a vehicle more efficient.

There are also substantial differences in the value financed in the various countries. On average, loans for vehicle purchases in Latin America finance around 70% of the value of the vehicle, although this depends on the country. In Chile, the development of the financial sector has made it possible to finance almost the total value of car purchases, whilst in Colombia and Venezuela the percentage financed is in the range 75-80%; in Argentina on the other hand, economic volatility and high interest rates over long periods have resulted in the finance available tending to be only around 50%.

7. Risks

The greatest risk faced by the global economy today is perhaps that the developed countries slip back into recession, whether in the case of Europe because of high levels of government debt, or in the United States due to a renewed slump in real estate prices or loss of confidence.

Any such double dip would reduce consumption and shrink the export sector in the U.S. This would affect Latin America through its impact on global and region-specific risk premiums, as well as through falling commodity prices, to which the region is sensitive. Any event of this type would also weaken confidence, slow private consumption and investment in Latin American and increase current-account deficits.

Our opinion is that whilst this would lead to lower growth for the countries in the region (1% or 2% lower than currently forecast), it would not result in a recession, as in the recent financial crisis. One of the reasons why the region will be able to withstand such a shock is that Asian countries will maintain their fast rate of growth, mainly backed by their strong domestic demand and continued room for maneuver in fiscal policy.

These global risks could impact the automobile sector, resulting in lower exports, particularly for those countries most linked to the U.S. cycle, such as Mexico. Taken together with a possible depreciation of the currency and higher finance costs, this would put a brake on the sector's growth (at least temporarily).

Another risk faced by the region is related to the current situation. There is excess liquidity in the Latin American economy, which is resulting in substantial capital inflows and currency appreciation. This in turn is harming the region's competitiveness in foreign markets. The threat is mainly to producer countries such as Argentina, Brazil, Colombia and Mexico. It is a challenge to their productivity.

Optimism about economic recovery (based on growth in emerging economies) in 2010 and new capital inflows should be properly handled to improve productivity in the automobile sector by implementing strategic plans including improvement in the skills of human resources, investment in new technology and entry into new markets. This will improve the region's competitiveness against third parties.

8. The future of the sector and conclusions

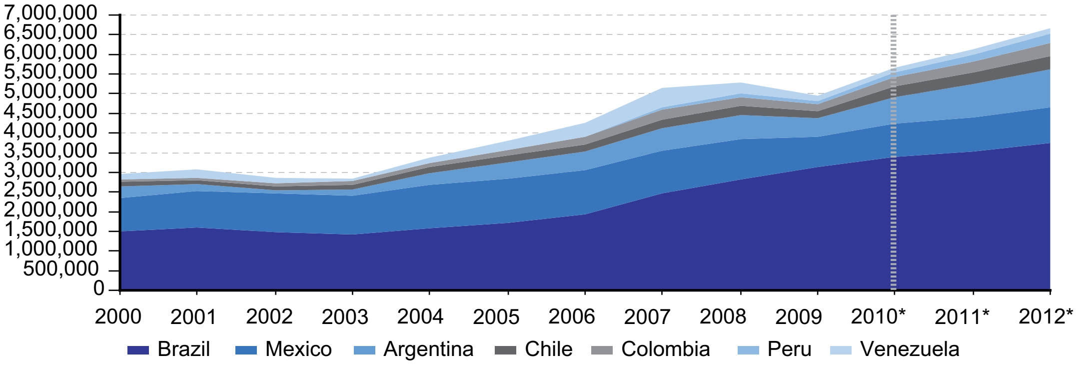
The automobile sector, which is strongly linked to domestic demand, is currently one of the drivers of economic growth in the region, and has significant capacity for growth in terms of both installed capacity and potential demand.

After suffering the effects of the global economic crisis in 2008-2009, in 2010 the industry has returned to the rapid rates of growth typical of the last decade. This dynamic performance is reflected in growth throughout the current year: sales to September 2010 were 11% higher than in 2009 due to highly favorable domestic and external factors.

This strength will continue over the coming two years, with annual growth at around 15%. The number of new vehicles sold annually should therefore exceed 6.5 million in 2012.

Chart 16

Forecast sales (units sold)



Source: BBVA Research

Despite the high growth rate in the automobile sector over recent years, countries such as Peru and Colombia still have a comparatively small vehicle fleet compared to other countries in the region. With favorable demand and supply conditions current sales figures could increase.

In addition, future demand in the vehicle market will be determined by the growth of an aspiring middle class, increased average income and greater export and import penetration.

There are also significant opportunities in terms of financing vehicle purchases. This is linked to expected supply and demand in the motor vehicle market over the coming years, as well as to the current situation of the finance market for such operations, in which there is significant room for development. First, the expected increase in the vehicle fleet implies that there will be increased needs for finance, particularly considering that finance for vehicle purchases does not exceed 2% of GDP in any country in the region and is as little as 0.3% of GDP in Peru and 0.7% in Colombia. This will provide short and medium-term support for business focused on this segment. Second, as mentioned above, the percentage of new vehicles financed is around 60%, which means there is scope for increased financing. Thirdly, there is also scope for increased lending for vehicle purchases in the second-hand vehicle sector, where banks currently have very limited penetration.

Providing that financial innovations are introduced to enable market penetration, significant expansion of finance for vehicles over the coming years will be possible, given the current low penetration of loans for new vehicles in some countries such as Argentina and Peru (where less than 30% of new automobile purchases are financed), the scope for extending finance to the second-hand vehicle market, expectations of significantly increased automobile demand and supply, and the interest shown by financial institutions.

To sum up, there are major opportunities in the automobile sector in Latin America. Despite strong performance over recent years, the vehicle fleet is still small, old and heavily concentrated in large cities. Other positive factors include the new middle classes, who will maintain rising demand over the coming years; the excess productive capacity in the sector compared to the rest of manufacturing industry; and the possibility of extending finance. All these mean that the automotive industry has great potential. However, the industry performance will be limited by the extent to which strategic projects related to productivity are implemented in order to achieve greater efficiency, economies of scale and value creation.

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