Automobile Market Outlook

Peru

2011
Economic Analysis

- **The positive growth trend of Peru's automobile market continued in 2011. We expected** that sales will surpass 150,000 units this year, an annual growth rate of over 25%
- **Higher households income together with increasing bank financing facilities are supporting the market.**
- **Sales of new vehicles will increase 20% annually over the coming years.** Transactions will therefore reach 220,000 units in 2013.
- **The main short-term risk faced by the sector is a double-dip global recession** that would lead locally to cutbacks in durable and investment goods spending. In the medium term a substantial improvement of the roads infrastructure will be needed.

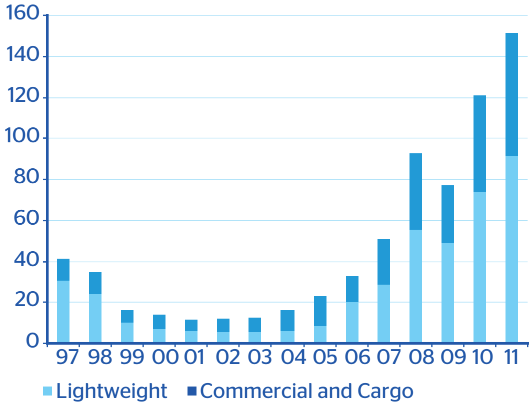
Index

Closing date: 1 December 2011

1. Automobile market development

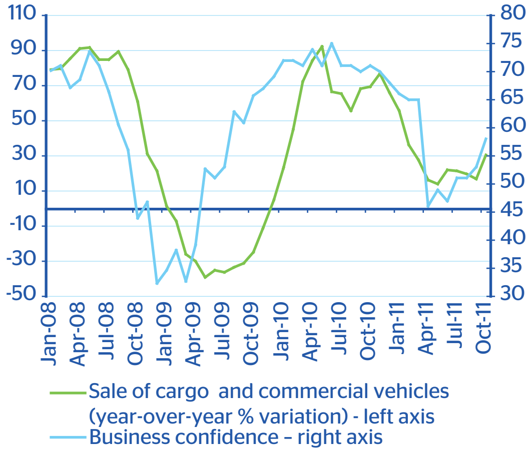
The positive growth trend seen over recent years in Peru's automobile market continued in 2011. As of October, sales of new cars have reached 122,000 units, and we estimate that these will reach 150,000 at year's end, an expansion of over 25% per year (see chart 1). This result would be less than the forecast in our previous report (around 160,000 units, or 35% growth) due to two factors. The first was the temporary shortage suffered by leading Japanese brands resulting from the earthquake in that country. The second, was the natural uncertainty generated by elections that led mainly companies and higher income families to postpone vehicle purchases, a behavior that has begun to correct itself over recent months (see chart 2).

Chart 1
Sales of new cars (thousands of units)



Source: Araper and BBVA Research Peru

Chart 2
Business confidence and vehicle sales



Source: Araper and BCRP

On the demand side, the dynamism of the market continues to be supported by the expansion of urban formal employment which, according to our estimates, would have grown this year around 5.5%, boosting the acquisitive power of families and the growth of the middle income households sector. As a result, it is foreseen that families vehicle sales will increase around 24% in 2011. Likewise, positive growth of business investment in mining, services, agricultural industry, and the manufacture gave supported the commercial and cargo vehicles market, which was reflected in an increase in their sales that will be around 27% at year's end.

On the supply side, conditions continued to adapt to this expansion of the automotive market. The network of dealerships, sale points and after-sale points (mechanical, maintenance, and spare parts sales) continued to extend, both in the capital of the country and in the provinces. This last point is of special importance given that the growth rate in provinces has surpassed that of Lima, increasing their share of new car sales from 20% in 2009 to 25% in 2011. Investments made will probably increase to USD 60 million this year, three times the amount of last year, according to the Association of Automobile Representatives of Peru (Araper for his spanish acronym). In addition, in a bid to get closer to the end user, showrooms are becoming more frequent.

A third element that has favored the positive development of the automobile market in 2011 has been the decrease of the average price of vehicles. On the one hand, competition between brands is higher (there are around 100 registered brands). The greater penetration of Chinese brands should be noted, although they still hold a small market share, as they are gradually coming to attract more customers with below average prices. Leading market brands (see table 1) have started to develop strategies adapted to the characteristics of each client segment, becoming more affordable and helping sales in the process. A second factor that has helped the reduction in prices has been lower taxes. In the first half of the year the sales tax was reduced by one percentage point to 18%. For their part, for import duties fell from 9% to 6% at the beginning of the year for light vehicles, while the entry into vigor of the Free Trade Agreement with South Korea in the third quarter of 2011 helped car sales from that country.

Table 1
Accumulated new car sales in 2011 (to October)

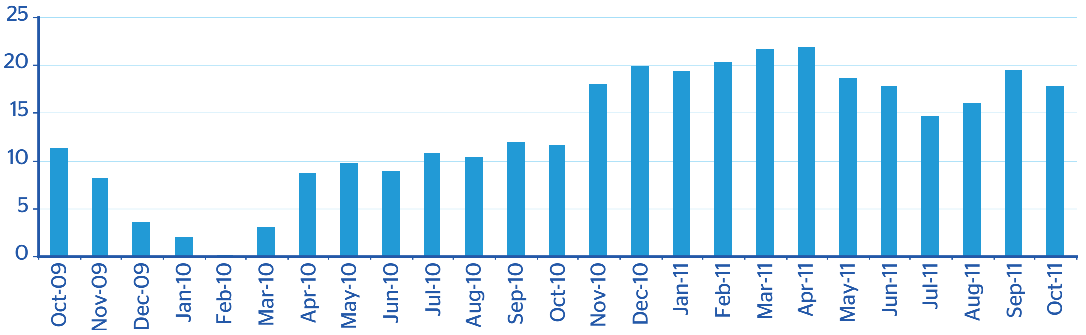
Brand	Overall total	Share (%)
Toyota	19,357	15.9
Hyundai	16,645	13.7
Kia	11,082	9.1
Nissan	10,665	8.8
Chevrolet	10,709	8.8
Volkswagen	6,179	5.1
Suzuki	5,787	4.8
Mitsubishi	3,241	2.7
Renault	2,538	2.1
Volvo	1,837	1.5
Miscellaneous	33,696	27.7
Total	121,736	100%

Source: Araper and BBVA Research Peru

2. Financing

Financing conditions have continued to accompany the dynamism of the automobile market. Thus, vehicle credit grew with respect to 2010 and is currently growing at a rate of 18% year over year (see chart 3). The total amount of these loans reached PEN 1.4 billion, which is still relatively low (1.15%) as a proportion of total banking credit.

Chart 3
Car loan balance (% y/y % variation)

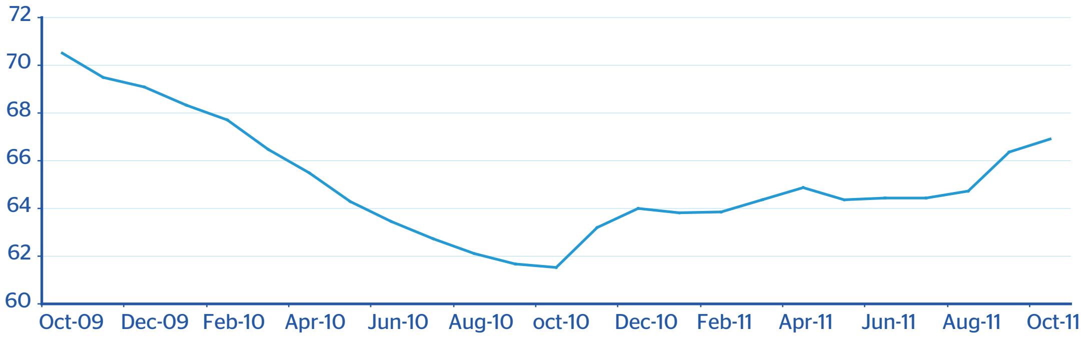


Source: SBS

The increase in volume of vehicle loans is not only due to increased demand for new cars, but also to more attractive conditions that the banks have been granting for this type of credit. For instance, the loans have been made more flexible in terms of repayment periods and also include special conditions for contracting auto insurance.

It worth mentioning, however, that these loans have been growing more quickly in foreign currency than in the domestic one (see chart 4). Clients appear to be choosing financing in dollars to take advantage of lower interest rates in that currency and the expectation that the strengthening of the PEN will make lower the debt burden down the road (the debt in foreign currency is lower when expressed in local currency). Although the vehicle loans delinquency has been relatively contained, these operations increase the exchange risk for the client (with local currency income) and consequently the credit risk for the bank.

Chart 4
Dollarization of the vehicle loans balance (% in USD)



Source: SBS

Looking forward, automotive credit has ample room to grow if one takes into consideration that only 20% of the purchases of new cars in Peru are with a bank loan, while in other countries like Chile, this figure is around 80%. For the moment, banks are launching new products that are more attractive to potential clients. Among these is the vehicle leasing system, which makes it possible to renew one's car every two to three years on a continuous basis and with affordable monthly payments (up to 40% lower than a traditional loan). It has also been seen that some financial entities are increasingly interested in financing used cars, a market estimated to be double that of the new cars market.

3. Future prospects of the Peruvian automotive market

We estimate that sales of new vehicles will increase 20% annually over the coming years. Due to this, transactions in the market will reach 220,000 units in 2013.

This forecast is based, on the demand side, by GDP growth that we expect to be 5% yearly over the next two years, which means that employment will continue to grow considerably. In addition, the creation in mid-2011 of the Automotive Fleet Renovation Program, also known as the "cash for clunkers" , could give an additional boost to the market. On the other hand, the local currency prices of vehicles will tend to diminish if the PEN continues to strengthen (auto prices are set in foreign currency) and if the entry into vigor of the free trade agreements continues to reduce import duties. Finally, it is foreseeable that the supply of vehicles and associated services will continue to adapt to demand growth, with the result that the dealers network will grow in both the capital and provinces of the country. In addition, the economy openness will favor greater competition between brands, with products more specifically suited to the various clients. To all this we can add that competition from imported used automobiles in the duty free zone will end in 2012 with the ending of the Centros de Exportación, Transformación, Industria, Comercialización y Servicios (CETICOS, Centers for Export, Transformation, Industry, Commercialization, and Services).

As for risks faced by the sector, the main short-term risk is a double-dip global recession with significant impacts at the domestic level. Although Peru has sufficient macro-economic strengths to moderate these impacts, it is probable that in this scenario both consumer and business confidence would weaken, which would particularly affect the demand for durable and capital goods, among which vehicles.

In the medium and long-term, the outlook is also positive. Peru's automobile market has ample room to grow, first because its starting point is very low. In this sense, the automotive fleet is small compared to other countries in the region with a similar income level. An additional factor is the age of this automotive fleet (17 years), wich inside the forecast context for the coming years will incentivize its renewal, even more so if the municipality of the capital maintains its objective of refurbishing public transport. It worth mentioning that because the existing state of the automotive fleet in the provinces is not as good as in Lima, expansion of the market in these regions could be more pronounced, as has been already occurring. Secondly, the greater penetration of vehicular natural gas, in line with the recent increase in investment for its supply stations, will provide access to a lower cost fuel, encouraging the demand for vehicles. Thirdly, the execution of important planned roads infrastructure projects will facilitate vehicle transit, mainly in the capital (see table 2). The growth of the automotive market, however, could be impeded in the medium term of not implementing these road works, the construction of additional parking spaces in the cities, or the extension of dealers with full service (vehicle sales, maintenance, and spares) due to the lack of available space and the limitation of municipal licenses.

Table 2
Main investment projects in the Municipality of Lima

Project	Status	Description	Estimated budget (million USD)	Start	End
Extension of the Paseo de la República expressway to Panamericana Sur.	Bidding in process	Extension of the Paseo de la República expressway to the Panamericana Sur highway.	185	Works will start in 2012	-
Metropolitano II	Contract yet to be awarded	The Metropolitano 2 (Subway 2) will run along Venezuela, Arica, Nicolás, Ayllón, and Grau avenues to Ate.	220	Works will at the end of 2012	Planned for possible completion in 2014
Javier Prado-La Marina Faucet Tunnel	Contract awarded to Graña y Montero	The works will consist in a toll tunnel under Javier Prado. It will be run by Graña and Montero.	700	2012	-
Periférico Vial Norte (project phase, contract to be awarded in the future)	Contract yet to be awarded	Links 11 districts and joins the North Panamerican Road with the South Panamerican Road and the Central Highway.	800	Works planned for possible start in 2012	-

Source: various news sources

4. Appendix

Table 3
Relevant indicators for the Peruvian automobile market

Population (thousands) 1/	29,798
GDP per capita (USD) 1/	5,970
Size of territory (thousands of square km)	1,285
Road network (thousands of km) 2/	79
Paved road network (% of road network) 2/	14
Vehicle fleet (thousands) 1/	2,100
Vehicles per thousand inhabitants 1/	70
Age of the vehicle fleet (years) 3/	17
% of households with at least one car 3/	9.5
Sales of new cars (units) 1/	151,000
Average price of cars (US$) 1/	12,079
New vehicles financing (% of new car sales) 4/	20
Average financed balance (US$) 4/	14,150

Memo: 1/ projection for 2011; 2/ latest information is from 2006; 3/ latest information is from 2009; 4/ average 2006-2011.
Source: Araper, INEI, MTC, and BBVA Research Peru

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This report has been produced by the Peru Unit:

Chief Economist for Latam Coordination
Joaquín Vial
+562 351 1200
jvial@bbva.com

Chief Economist for Peru
Hugo Perea
+51 1 2112042
hperea@grupobbva.com.pe

Francisco Grippa
+51 1 2111035
fgrippa@grupobbva.com.pe

Daniel Barco
+51 2111548
dbarco@grupobbva.com.pe

Isaac Foinquinos
+51 1 2111649
ifoinquinos@grupobbva.com.pe

BBVA Research

Group Chief Economist
Jorge Sicilia

Emerging Markets:
Alicia García-Herrero
alicia.garcia-herrero@bbva.com.hk

Cross-Country Emerging Markets Analysis
Álvaro Ortiz Vidal-Abarca
alvaro.ortiz@bbva.com

Asia
Stephen Schwartz
stephen.schwartz@bbva.com.hk

China

India
Sumedh Deorukhkar
deorukhkar@grupobbva.com

Latam Coordination
Joaquín Vial
jvial@bbva.com

Argentina
Gloria Sorensen
gsorensen@bbva.com

Chile
Alejandro Puente
apuente@bbva.com

Colombia
Juana Téllez
juana.tellez@bbva.com

Peru
Hugo Perea
hperea@grupobbva.com.pe

Venezuela
Oswaldo López
oswaldo_lopez@provincial.com

Mexico
Adolfo Albo
a.albo@bbva.bancomer.com

Macroeconomic Analysis Mexico
Julián Cubero
juan.cubero@bbva.bancomer.com

Developed Economies:
Rafael Doménech
r.domenech@bbva.com

Spain
Miguel Cardoso
miguel.cardoso@bbva.com

Europe
Miguel Jiménez
mjimenezg@bbva.com

United States
Nathaniel Karp
nathaniel.karp@bbvacompass.com

Financial Systems & Regulation:
Santiago Fernández de Lis
sfernandezdelis@bbva.com

Financial Systems
Ana Rubio
arubiog@bbva.com

Pensions
David Tuesta
david.tuesta@bbva.com

Regulation and Public Policy
María Abascal
maria.abascal@bbva.com

Global Areas:

Financial Scenarios
Sonsoles Castillo
s.castillo@bbva.com

Economic Scenarios
Juan Ruiz
juan.ruiz@bbva.com

Innovation & Processes
Clara Barrabés
clara.barrabes@bbva.com

Market & Client Strategy:
Antonio Pulido
ant.pulido@grupobbva.com

Equity Global
Ana Munera
ana.munera@grupobbva.com

Global Credit
Javier Serna
Javier.Serna@bbvauk.com

Global Interest Rates, FX and Commodities
Luis Enrique Rodríguez
luisen.rodriguez@grupobbva.com

Contact details

BBVA Research Latam
Pedro de Valdivia 100
Providencia
97120 Santiago de Chile
Tel: + 56 26791000
E-mail: bbvaresearch@bbva.com