BBVA Research

Argentina

Automobile Market Outlook

December 2010

Economic Analysis

- The vehicle fleet has soared over recent years improving the ratio of vehicles per inhabitant which stood at 4.4 in 2008, above regional averages but still significantly below ratios in developed countries. The average age of the vehicle fleet is relatively high.
- The demand for vehicles is predominantly for low- and medium-priced cars, with Volkswagen and Chevrolet leading the rankings.
- The local industry comprises 10 car manufacturers and has grown substantially since the 1990s on the basis of the compensated trade agreement within MERCOSUR, as a result of which 60% of vehicles sold in the local market are imported, mainly from Brazil.
- Argentina has a large trade deficit in auto parts. This has led the authorities to implement credit lines for SMEs in order to increase the percentage of domestic components in locally manufactured vehicles by 10%.
- Vehicle sales are strongly pro-cyclical. Significant increases are forecasted for 2011 and 2012 as per capita income will continue to grow and interest rates will remain low, although at a slower pace than in 2010
- Financing, whether from banks or manufacturers' financing agencies, remains underdeveloped in Argentina (it represents just 30% of total sales) as a result of persistently high inflation and informality in labor markets.

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Closing date: 19 November 2010

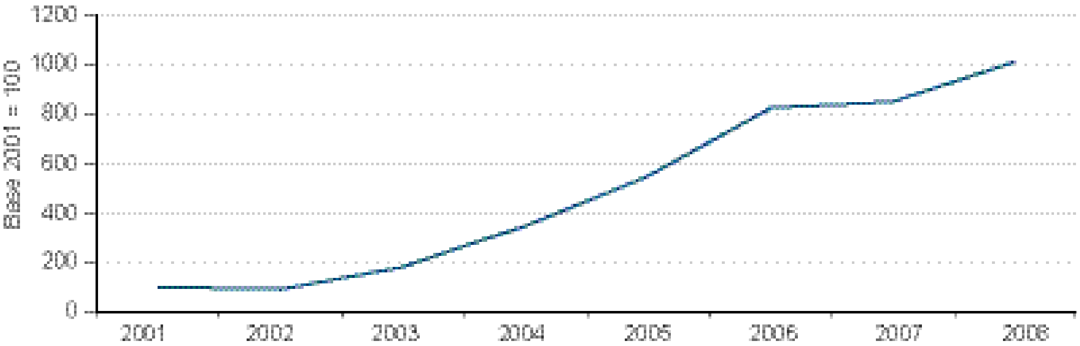
1. Argentina is a market with high potential given its income per capita and its geographical size

Argentina is one of the larger automotive markets in Latin America, in a second group of countries behind the leading regional players, Mexico and Brazil. Moreover, with 40.1 million inhabitants and a GDP per capita of USD 7,850 per year (2009 figures), potential for growth is high, given the limited levels of financing available as a consequence of high macroeconomic volatility.

Its extensive geographical area (2,791,810 km2) and limited population density (14.2 inhabitants per km2) is serviced by a road network of 38,920 km (2008 figures), of which 88.4% is paved. Investment in road infrastructure, mainly new works, has increased significantly in recent years (by a factor of nine between 2001 and 2008, see Chart 1).

Chart 1

Road infraestructure investment at constant prices



Source: BBVA Research using MIPLAN data

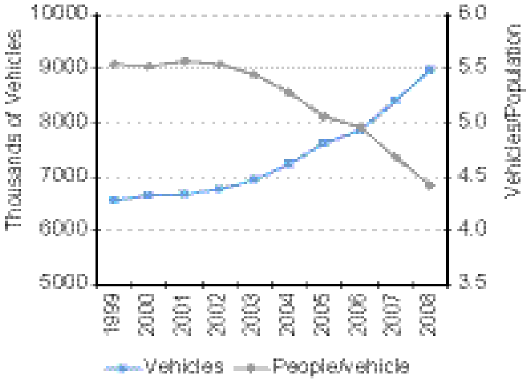
However, the deterioration of the rail network has led to the shift from rail freight transport to road haulage by trucks. As a result, the main roads in the country, particularly those connecting with MERCOSUR, are saturated and require new investment. In the case of Buenos Aires, the steep rise in the number of vehicles over the last 5 years, coupled with migration towards the suburbs, has resulted in major traffic congestion in the access to the downtown areas that affects both the public transport of passengers by bus and the movement of private vehicles.

2. Motorisation has increased, but the vehicle fleet is still relatively old

The Argentinean motor vehicle fleet in 2008 (latest available figures) numbered 12,982,537 units, of which about 8,976,712 were still running, a ratio of one car per 4.4 inhabitants.

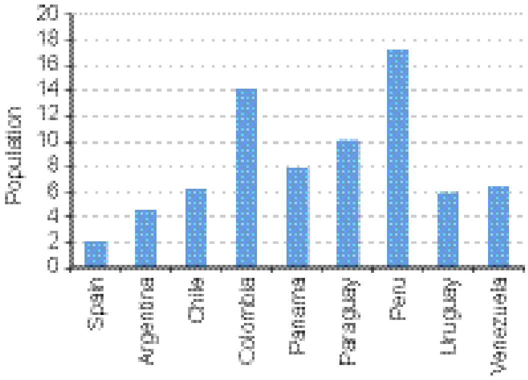
The size of the vehicle fleet has increased sharply over the last three years. As a result, this ratio has improved, as will become even clearer when the new figures corresponding to 2009, and in particular 2010, are incorporated into the statistics (see Chart 2).

Chart 2
Vehicle fleet in Argentina



Source: BBVA Research

Chart 3
People per vehicle



Source: BBVA Research

Although Argentina has a higher density of cars per person than most of the countries in the region, it is still far behind the density observed in developed countries such as Spain, where the ratio of people to cars is practically half (see Chart 3).

Just over a quarter of the vehicle fleet on the road is up to 5 years old, and as much as 38.8% is up to 10 years old (see Table 1).

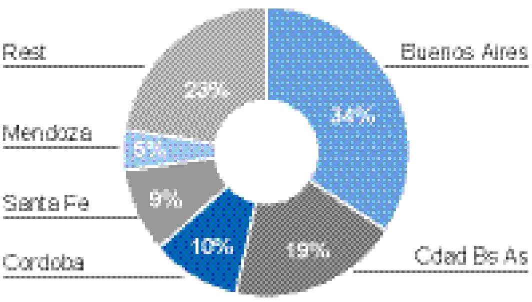
Table 1
Age of vehicle fleet

From	To	Units	Share %
	1988	2518966	28.1%
1989	1993	947826	10.6%
1994	1998	2027243	22.6%
1999	2003	1172373	13.1%
2004	2008	2310304	25.7%
	Total	**8976712**	**100.0%**

Source: DNRPA

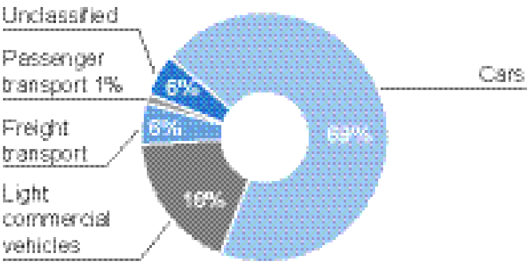
Over 50% of the vehicle fleet is located either in the province of Buenos Aires (34.26%) or the City of Buenos Aires (19.13%).

Chart 4
Vehicle fleet by province



Source: DNRPA

Chart 5
Vehicle fleet by category



Source: DNRPA

Cars represent the most important category within the vehicle fleet, at 69.9%, followed by light commercial vehicles, at 18.1% (see Chart 5).

With regard to public passenger transportation, information from the Secretariat of State for Transport reveals that the 135 bus lines within the metropolitan area of Buenos Aires carry 9,688 vehicles in circulation with an average age of 7.13 years. Although there has been an improvement in the age of the vehicle fleet over the last two years, it is still higher that in the last years of the Convertibility Regime, due to the negative impact of the 2002 crisis and the subsequent delay in adjusting prices for the sector.

In contrast, the fleet of vehicles making up the long-distance transport lines has been renewed, with 132 companies handling a total of 4,439 vehicles at an average age of 3.4 years.

The average age of taxi fleets is also lower. More than 50,000 cars are estimated to be in use as taxis in the country, of which 42,810 are in the city of Buenos Aires and are an average of 4.9 years old.

3. Demand for low- and medium-priced cars is the largest

New car sales numbered 486,000 units in 2009, at an estimated value of around USD 13,400m, of which 48.4% were low- and medium-priced, 22.8% high-end and 23.6% light commercial vehicles. The remaining 5.2% corresponded to bus and heavy trucks, though it should be noted that these figures were greatly affected by the major fall in investment over the last year as a result of the contraction in activity due to the international crisis.

Market leaders within the segment of cars and light passenger and commercial vehicles were Volkswagen (20.7%), followed by Chevrolet (14.5%) and Ford (13.1%).

Table 2

Sale of cars and light vehicles by make to public

		2009		2008	
	Marque	Units	Share %	Units	Share
1	Volkswagen	102329	20.7%	109287	19.1%
2	Chevrolet	71622	14.5%	85617	14.9%
3	Ford	64721	13.1%	69685	12.2%
4	Renault	60884	12.3%	68662	12.0%
5	Fiat	49674	10.1%	63611	11.1%
6	Peugeot	45748	9.3%	59130	10.3%
7	Toyota	29120	5.9%	30523	5.3%
8	Citroën	20324	4.1%	22214	3.9%
9	Honda	15085	3.1%	18722	3.3%
10	Suzuki	6775	1.4%	9335	1.6%
11	Mercedes Benz	4856	1.0%	6383	1.1%
12	Nissan	4071	0.8%	6234	1.1%
13	Hyundai	3317	0.7%	4663	0.8%
14	Audi	2678	0.5%	3261	0.6%
15	Kia	2187	0.4%	3679	0.6%

Source: BBVA Research using ACARA data

In the segment of heavy goods vehicles, buses and trucks, the leading brand is Mercedes Benz (41.0% of the total), followed by Ford (19.0%) and Iveco (11.3%) (see Table 3).

Table 3

Sale of heavey utility vehicles by make to public

		2009		2008	
	Marque	**Units**	**Share %**	**Units**	**Share %**
1	Mercedes Benz	5540	41.0%	8171	35.7%
2	Ford	2561	19.0%	4538	19.8%
3	Iveco	1531	11.3%	3120	13.6%
4	Volkswagen	1218	9.0%	2727	11.9%
5	Scania	926	6.9%	1629	7.1%
6	Agrale	618	4.6%	679	3.0%
7	Reanault	348	2.6%	636	2.8%
8	Volvo	329	2.4%	778	3.4%
9	Puma de Tat	183	1.4%	363	1.6%
10	Hyundai	182	1.4%	231	1.0%

Source: BBVA Research using ACARA data

4. Most sales through dealers and in cash

Sales are basically made through three channels: a) dealers, who overall account for 65% of the sales, with many of them being multi-brand dealers; b) special sales by carmakers directly to corporate customers; and c) special savings plans designed for car purchase organized by the carmakers themselves.

Most sales of new cars are paid for in cash (69.8%); while the remaining 30.2% are financed (48.3% of which correspond to the savings plans mentioned above). This distinguishes the Argentinean market from that of Brazil, where the proportions are reversed, with a clearly higher number of financed sales. However, the financing of car purchases is actually slightly higher than that indicated by these figures, as some personal loans are used for this purpose, although the sales themselves are registered as being in cash.

In terms of the second-hand market, transfers in 2009 numbered 1,327,734 units, though no reference price can be identified due to the informality that is a characteristic of this market. This also explains the low financing level in the segment of second-hand cars, estimated at only 5% of transfers, with the remaining 95% made in cash.

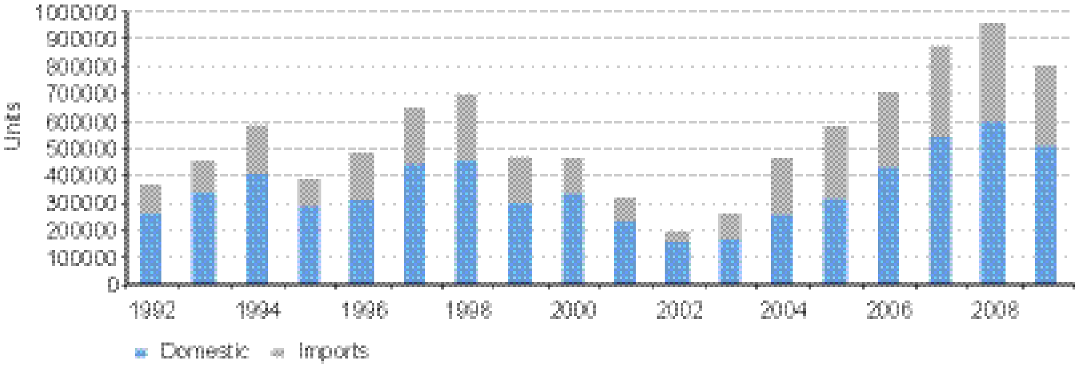
5. Strong regional integration in automotive supply

The automotive industry in Argentina has 10 manufacturers in operation with plants in the provinces of Buenos Aires, Santa Fe, Córdoba and Tucumán. Of these, 9 plants manufacture assembled units while the other makes gearboxes. Domestic output is among the 25 biggest in the world ranking of top vehicle producing countries, though the precise figure varies according to the year.

The manufacturers operating in Argentina are Fiat Auto, Ford, General Motor, Iveco, Mercedes Benz, PSA Peugeot-Citroen, Renault, Toyota and Volkswagen. They manufacture assembled units in one or all of the market segments. Scania only manufactures gearboxes.

Following the major slump provoked by the 2002 crisis, the vehicles supply began a sustained process of recovery, which was only interrupted in 2009 by the impact of the international crisis that affected both domestic production and imported units. However, there was a major recovery in 2010 with accumulated year-on-year growth of 43.8% to October. Production in terms of number of units is estimated at 700,000 for the full year, an increase of more than 36% year-on-year and above the all-time highs posted in 2008.

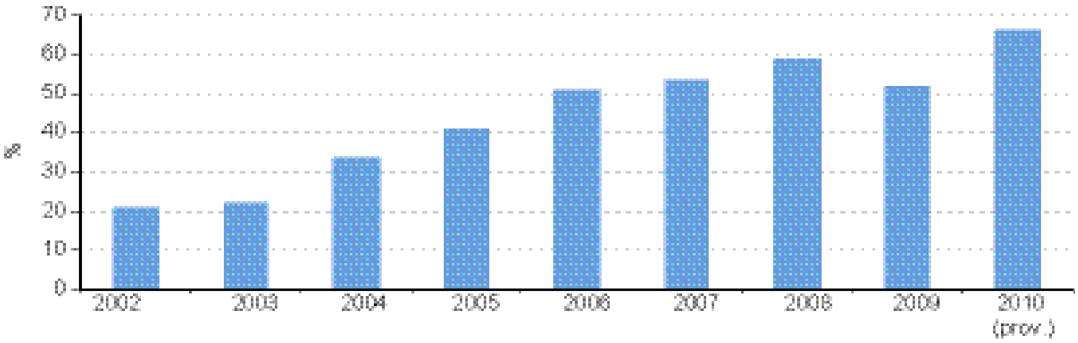
Chart 6
Automotive supply



Source: ADEFA

Despite the significant growth in the industry since 2002, there is no scarcity of idle capacity. The INDEC survey shows that utilization of installed capacity is at 66.5%, below the general average for manufacturing industry, which stands at 75.5% (see Chart 7).

Chart 7
Installeda capacity utilization



Source: Indec

Although the car industry has a long tradition in Argentina, with the first manufacturers settling over 50 years ago, it is only from the 1990s that activity received a new boost through integration into MERCOSUR and the implementation of regional strategies by carmakers. Closer international links meant that processes and models were updated and trade flows increased in both directions in the sector. Following the agreement within MERCOSUR and the close relationship established with Brazil, there were complementary agreements with Mexico and Chile.

6. Balanced trade with Brazil allows some flexibility

The automobile trade agreement between Argentina and Brazil has determined the framework within which most international trade in the industry operates. The current agreement expires in 30 June 2013, after which either free trade will exist between the parties, or a new agreement will be concluded.

The treaty covers an intra-area compensated exchange of vehicles in all categories, including parts, components and accessories, with a 100% preferential customs treatment (0% tariff), provided that the products comply with the requirements of origin. Manufacturers from outside the zone are subject to a Mercosur common external customs tariff of 35%.

Trade flows are monitored and the administrative model establishes different flexible (Flex) coefficients of deviation in bilateral trade for each country. If Argentina runs a deficit in its bilateral trade with Brazil, the ratio between the value of imports and exports must maintain a coefficient of deviation on the value of annual Argentinean exports not greater than 1.95.

If Brazil runs a trade deficit, the ratio between the value of imports and exports must maintain a coefficient of deviation on the value of annual Brazilian exports not greater than 2.50.

In this way, the conditions agreed reflect the different capacity of each economy to face an imbalance in the sector, thus allowing a greater deficit for Brazil.

There are no maximum limit for exports to the extent that the established Flex limits are complied with. Companies based in territories of one or the other country that has a surplus in their exchange may transfer their credit to companies running a trade deficit. If this global exchange remains above the limits provided for under the Flex even after using this transfer scheme, reductions will be applied in the customs tariff preferences of 100%.

The automotive products in question must have a minimum regional MERCOSUR content of 60%. In the case of new models manufactured in the territory of one of the parties, a 2-year schedule for gradual integration has been established. This stipulates a minimum regional component of 40% at the start, 50% in the first year, and 60% in the second year, as for the general regulations.

7. Strong trade deficit in the auto parts trade sector

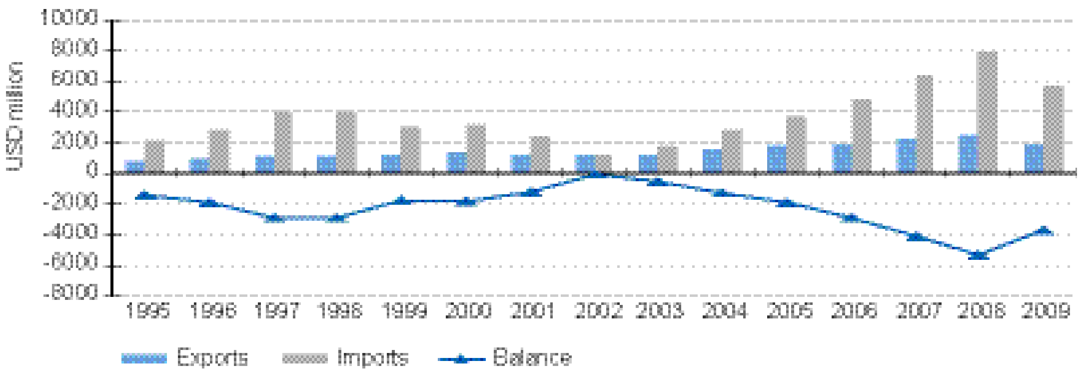
A glance at the automotive value chain shows that Argentina has suppliers of basic products in steel, aluminum and plastics. The input markets are monopolies or oligopolies, and the existing companies are not exclusive providers of the automotive industry. In fact, they supply a broad range of sectors, including electrical appliances and construction.

The auto parts industry is made up of around 400 companies, mostly SMEs, which directly employ around 52,800 workers. Total sales in the sector were USD 3,930m in 2009. The main destinations of the auto parts manufactured in Argentina were Brazil, the United States, Mexico and Venezuela, while the countries of origin of the imports were headed by Brazil, followed by Germany, China and the United States.

The level of domestically-produced parts in vehicles is a concern for the Argentinean authorities, due to its impact on the balance of trade. It is estimated that only 20% of the parts in a vehicle considered “domestically manufactured” are actually domestic in origin. Figures for the first half of 2010 show a deficit of USD 2,797m in auto parts trade, 109% above the same period the previous year.

With the aim of increasing by 10% the proportion of Argentinean car parts, the Ministry of Industry is studying the provision of subsidized financing for 150 auto part investment projects for a total value of ARS 1.4 billion.

Chart 8
Auto part foreign trade



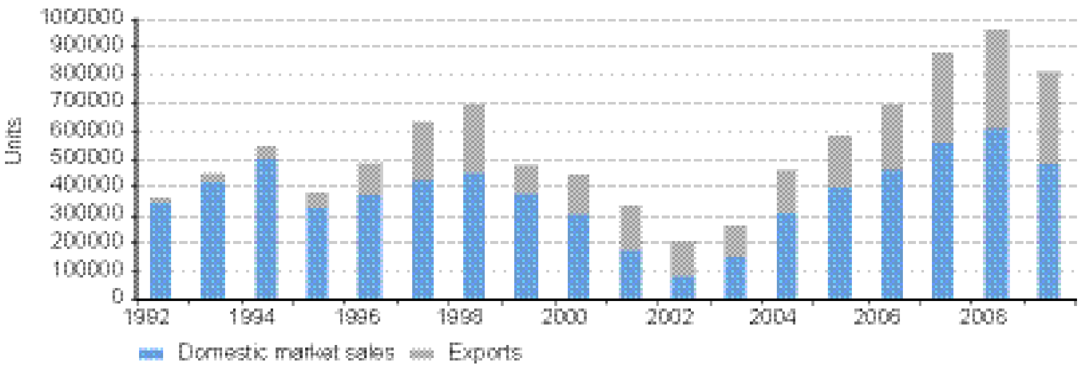
Source: ACARA

8. Exports account for 60% of the demand for domestically-manufactured vehicles

With the integration of the industry to the international (above all regional) scene, exports are an important component in demand for domestic manufactured vehicles (60.6% over the last two years), while imported vehicles represent a significant part of total sales in the domestic market (60.2% in the same period). The main destinations of exports are Brazil and Mexico, although there were also smaller amounts sold to other countries in Latin America, Europe, Asia and Africa.

Chart 9

Automotive demand



Source: ADEFA

After the contraction in the markets in 2009 as a result of the global crisis, there was a major recovery in demand in 2010, both domestic and external. In the first 10 months of 2010, exports totaled 358,067 units (up 44.0% y/y), while sales on the domestic market, including both locally manufactured and imports, totaled 558,723 vehicles (up 39.5% y/y).

9. The determinants of demand

Car sales tend to accentuate the economic cycle and showed an elasticity of 4.6 with respect to GDP in the last growth cycle of 2002/2008. As these are durable goods, demand is influenced by future expectations related to economic performance as well as improvement in income per capita. As the fall in unemployment and the improvement in real wages for workers increase accessibility, consumer expectations with respect to whether these improvements are temporary or permanent play an important role.

In 2010, demand for durable goods was boosted by acelerating inflation and continued low interest rates. These have created a disincentive to saving and boosted demand for cars as a hedge value. Although the total wage bill can be expected to continue increasing in 2011 and monetary conditions will probably continue to be lax, the uncertainty linked to the electoral cycle will have a negative impact on confidence and the purchase of durable goods, thus reducing the rate of expansion in the sector.

In the medium term, the continued growth of the economy and a deceleration of inflation, will enable the sector to develop with an increased use of bank finance.

The tax component is not a determinant factor in demand for cars manufactured inside MERCOSUR, as only in the case of a vehicle costing more than ARS 170,000 are internal taxes payable with a surcharge of 10.0%; otherwise, only 21% of value added tax (IVA) is applicable. For a vehicle imported from outside the Mercosur area, an additional 35% customs tariff is added. This mainly affects high-end vehicles.

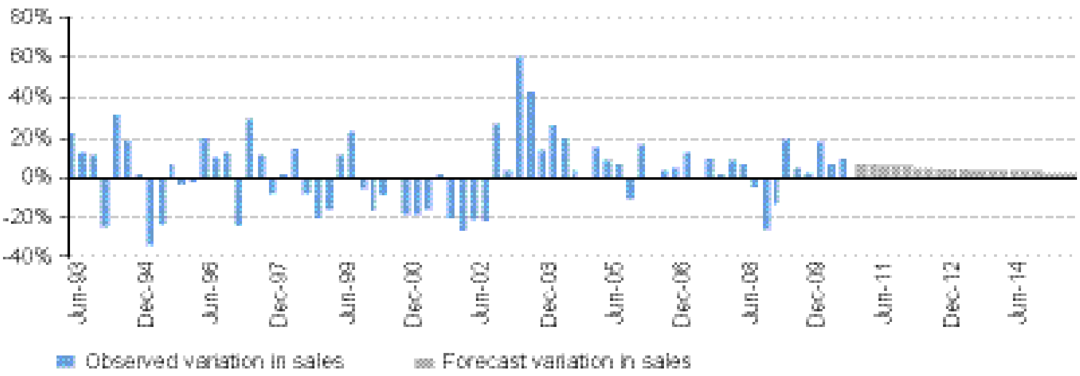
10. Medium-term prospects for demand

We estimate a simple econometric model to assess the outlook for automobile demand in Argentina over the coming years. The model links total car sales with the interest rates of car loans (in which the car is used as collateral), the real interest rate, GDP per capita and the price of vehicles[1].

Estimates suggest that, in our base scenario of sustained per capita output growth and continuing real negative interest rates, the prospects for the sector are positive as that there will be continued sales growth, although at a slower rate than this year. Sales are expected to reach 950,000 units in 2012, 14% above the figure for 2011, which at 836,400 units will in turn show a growth of 23% on 2010 values (see Chart 10).

Chart 10

Vehicle sales (base scenario, quarterly variation, %)



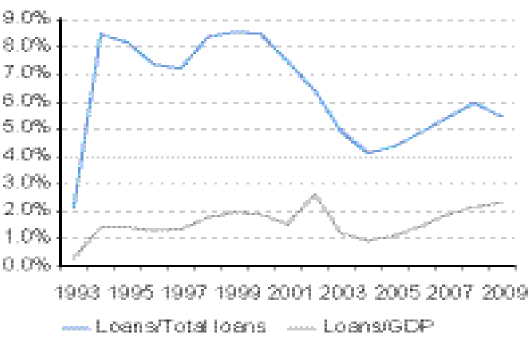
Source: BBVA Research

11. Low financing ratios

Due to the volatility of the Argentinean economy and high nominal interest rates over prolonged periods, the use of finance in the purchase of vehicles is very low in Argentina (as in the case of housing) compared with other countries in the region. Car loans have never accounted for more than 9% of total lending and barely 2% of GDP (see Chart 11). Another factor that has an effect on these figures is the high rate of informality in the labor market (around 36% of workers), which makes it more difficult for people to access bank credit.

Chart 11

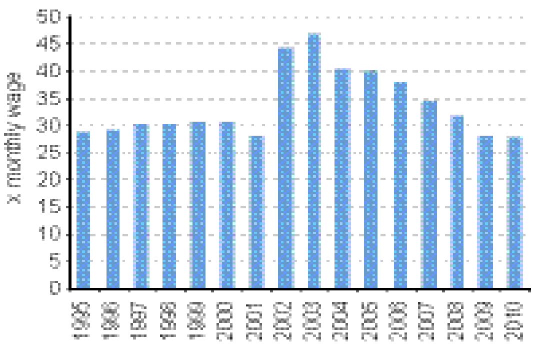
Car loans



Source: BBVA Research

Chart 12

Access to vehicle



Source: BBVA Research

1: It is a linear single-equation model estimated by ordinary least squares at quarterly frequency. It relates the first difference of the logarithm of total car sales with the first lag in the nominal interest rate of the car loans and the real interest rate, the rate of growth of per capita output and the quarterly change in the price of cars. The model was estimated using quarterly data from between 1Q 1993 and 3Q 2010. All the variables are statistically significant to within 5%, except the real interest rate, which is significant to 10% (its p-value is 0.069).

Accesibility has improved for formal workers after the economy plunged in 2002, due to the increase in real wages. Over recent years it has reached similar levels to the best in the historical series, with 28 monthly wages required for the purchase of a compact family car (see Chart 12).

On the finance supply side, it is worth highlighting the importance of financing companies linked to the carmakers who have a 30% share of the car loans, in direct competition with the banks. In some cases, these companies are associated with a bank and have the advantage of better developed collection units in case of a sustained increase in default rates during recessive cycles.

Currently, with output expanding substantially and with positive prospects for the economy over the coming years, sales will probably continue to expand and there will be no problems in the marketing chain. The NPL rate is estimated at only 1% in the current portfolio, due not only to the general economic situation, but also the role that vehicles have as a hedge value in an inflationary context.

On average, loans for car purchases finance up to 50% of the value of the vehicle at terms of up to 5 years. At the close of this report, interest rates for car loans varied between 16.5% and 22% p.a., representing a negative rate in real terms. However, the importance of loan-linked insurance (life and car) should be taken into the account in the total financial cost. This shows the potential for cross-selling involved in car loans both due to the related insurance products and to the fact that they tend to enhance customer loyalty in the medium term.

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