BBVA Research

Peru

Automobile Market Outlook

Year 2010

Economic Analysis

- Peru Automobile Market Outlook is an annual report that BBVA Research offers its clients. In it, both recent trends in the Peruvian automotive sector and short- and medium-term perspectives are analyzed, assessing demand and supply factors that affect this market.
- The Peruvian automotive market presents healthy prospects, with an increase in sales which we estimate will hover around 35% per year over the coming years. With a vehicle fleet that is relatively small, old, and concentrated in Lima, as well as adequate conditions on the supply and demand side, the potential for growth is high.
- For its part, supply will continue to adapt to demand and extend the range of brands and models, with greater investment in selling points and better after-sale service. The probable ending in 2012 of licenses to import used vehicles will boost expansion of the new car market.
- Among the factors that will boost demand are the increase of the average household income over recent years and prices that will remain at attractive levels due to greater competition both in brands and models. An additional positive impact on demand is access to vehicles that use lower-cost fuel alternatives such as natural gas, the availability of which is guaranteed for the coming years in the local market due to existing reserves in the country.
- In this context, vehicle financing has room to grow, especially given that the current penetration of bank credit in the automotive market is low and that the secondary car market is not currently served.

Index

Closing date: 17 November 2010

1. Introduction: Peruvian vehicle fleet

The Peruvian vehicle fleet is relatively small and old, and concentrated in the city of Lima (the capital of the country). Nevertheless, it has been growing steadily over recent years, a trend attributable to various factors on both the supply and demand sides. The characteristics of its initial conditions **(see Table 1)** and the expectation that boost factors will continue to evolve favorably over the coming years augur interesting opportunities for the Peruvian automotive market in the short and medium term.

Table 1

Relevant indicators for the Peruvian automotive market, 2009

Population (thousands of persons)	29,101
GDP per capita (USD)	4,356
Extension of the territory (thousands of square km)	1,285
Road network (thousands of km) 1/	79
Paved road network (% of road network) 1/	14
Vehicle fleet (thousands of units)	1,733
Vehicles per 1,000 people	60
Age of the vehicle fleet (years)	17,0
% of households with at least one car	10
Sales of new cars (units per year) 2/	120,000
Average price of cars (USD) 2/	13,219
Average vehicle loan (USD) 3/	14,031
New vehicles financing (% of new car sales) 3/	20

Memo: 1/ latest information 2006, 2/ projection for 2010 and 3/ average 2006-2010
Source: MTC, IMF, Araper, Encuesta Nacional de Hogares (National Households Survey) 2009. Compilation: BBVA Research Peru

Size of the fleet

Until the end of the 1980s, the automotive market was characterized by its severe lack of competitiveness. The domestic supply in vehicles was concentrated in a few companies (among the main ones Nissan, Toyota, Volkswagen, and Chrysler) which engaged in local assembly and whose production process was very costly. Car imports, on the other hand, were not very attractive due to the high tariffs imposed. Against this backdrop, the growth of the vehicle fleet was very limited.

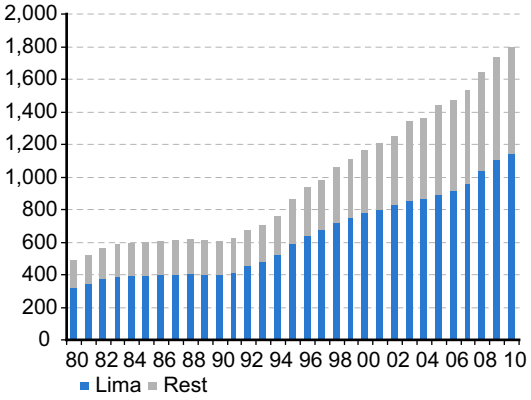
With the reforms in the 1990s, markets were liberalized, making it easier to import not only new, but also used vehicles. Since then, the automotive fleet has expanded steadily, increasing from 600,000 units in 1990 to 1.8 million in 2010 according to information from the Ministry of Transport and Communications **(see Chart 1)**. The greater part of the fleet is made up of automobiles, with close to half of the total, while 15% are station wagons, 12% pick-up trucks, and the rest trucks, buses, and trailers.

But in spite of this expansion, the size of the automotive fleet in Peru continues to be relatively small when compared to other countries. For instance, automobile take-up by the Peruvian population is only 50% of what it is in Colombia and a third of what it is in Chile **(see Chart 2)**. Adjusting for the differences in the incomes of the population, the situation is similar. And this is even more obvious if we consider that the cities of these other countries boast better quality transport systems, so that there should be a greater tendency there to rely more on this service.

Age of the fleet

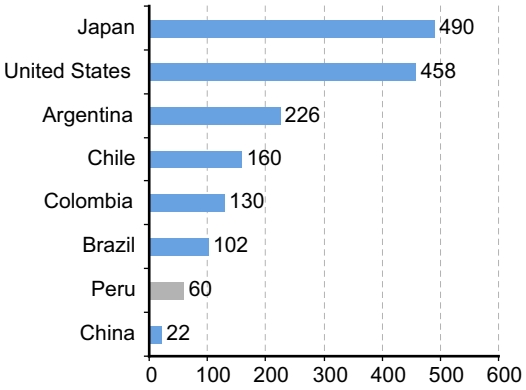
Greater facilities for imports, in particular those aimed at used vehicles, have not only contributed to the expansion of the automotive fleet, but have also resulted in an aging fleet. The figures show that imports of used vehicles has been significant, mainly from Asia, and accounts for about half of the growth of the fleet over the last decade. As a result, the average age of the automotive fleet in Peru is 15.5 years for private transport vehicles and 22.5 years for public transport vehicles, according to.

Chart 1
Automotive fleet (thousands of units)



Source: MTC

Chart 2
Automotive fleet in 2008 (vehicles per 1,000 people)

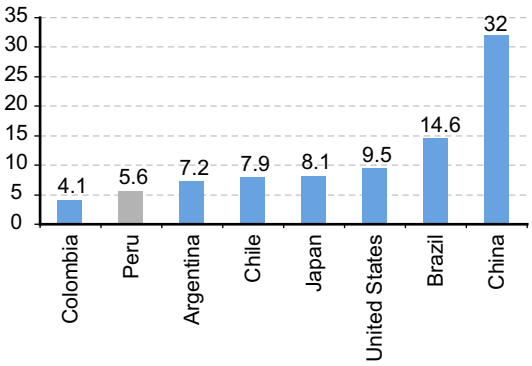


Source: various sources

Asociación Automotriz del Perú (AAP). In Metropolitan Lima, for instance, the average age of buses is 19 years (13 in Bogotá and 5 in Santiago de Chile), 18 years in the case of microbuses and 16 years in the case of "combis"[1], which is due to a large extent to the fact that the addition to the city's fleet of this type of vehicles mainly consists of used ones.

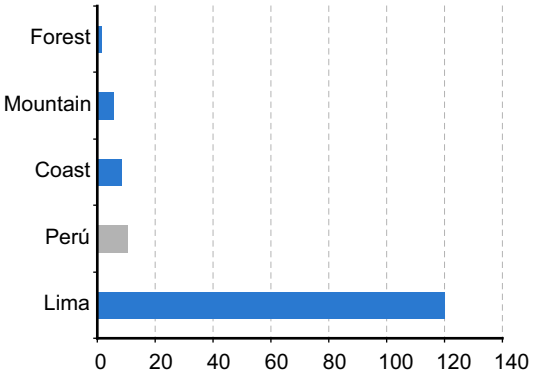
Therefore, although the growth of the Peruvian automotive fleet has been sustained over the last decade, this has been accompanied by a relatively low average rate of renewal (sales of new vehicles over automotive fleet), of about 2%. Although there have been improvements in this rate over the last three years, it is still low when compared to other countries, especially if the high average age of the fleet is taken into consideration **(see Chart 3)**. In this respect, as import facilities for used vehicles are limited (according to what is planned), this should help in reducing the average age of incoming vehicles.

Chart 3
Renewal rate of the automotive fleet in 2008 (%)



Source: Bloomberg, IMF, and various sources

Chart 4
Automotive fleet/GDP per person in 2009 (number of vehicles)



Source: MTC, INEI

1: The "combi" is a light passenger transport vehicle for urban use (capacity 16 people).

Concentration of the fleet

In regional terms, most of the fleet is concentrated in the country's capital. In 2009, for instance, Lima was home to two thirds of Peru's automotive fleet (1,1 million vehicles), far ahead of regions such as La Libertad (9%) and Arequipa (6%), with the other thirteen regions amounting to less than 1% of the total. This situation reflects the greater population of the capital (with 30% of Peru's population) and the higher relative income there, in addition to the greater road density and better infrastructure than in the rest of the country. Nevertheless, comparing the penetration of vehicles per GDP unit at the regional level a similar figure is obtained: a high concentration of the automotive fleet in Lima **(see Chart 4)**. Although the topography of the country's interior is more difficult than that of the capital, differences in this indicator suggest that there are opportunities for growth in the Peruvian provinces.

In sum, the initial conditions of the automotive market in Peru, i.e., its relatively small size, its old age, and its high geographic concentration, suggest that market development opportunities can be interesting if the supply and demand factors influencing the market are favorable over coming years.

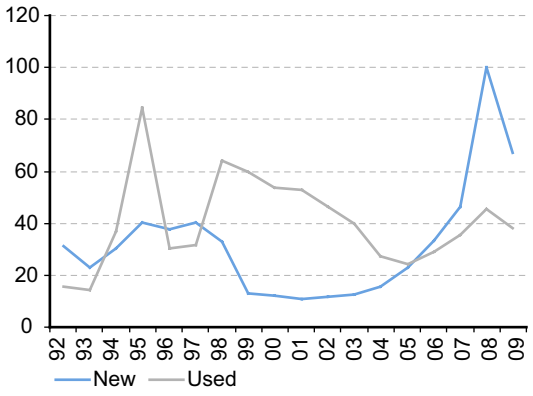
2. Supply of vehicles

In Peru, all vehicles supplied are imported, which includes both new and used vehicles **(see Chart 5)**. This supply generally adapts to demand conditions. Thus, greater demand associated with economic growth over recent years, together with the reduction in tariffs on the importation of vehicles (elimination in the case of cargo vehicles), among other factors, have boosted the volume of imported vehicles, and this was reflected in an annual expansion averaging nearly 50% of the value of vehicle imports between 2006 and 2008, which was only interrupted in 2009 by the global economic crisis. This year so far (up to July), the value of vehicle imports has grown by 42%.

By source market, vehicle imports are highly concentrated, with those from Japan and South Korea amounting to 60% of the value of vehicles purchased abroad, while those coming from other countries such as Mexico, the United States, Germany, China, and Brazil are not as significant **(see Chart 6)**. In general, this structure has seen little change in recent years due to the marked preference of Peruvian consumers for Japanese vehicles. However, Chinese imports have made notable progress since 2008, which reflects the interest of new demand segments (young professionals and independent workers) in low-cost vehicles (under USD 13,500).

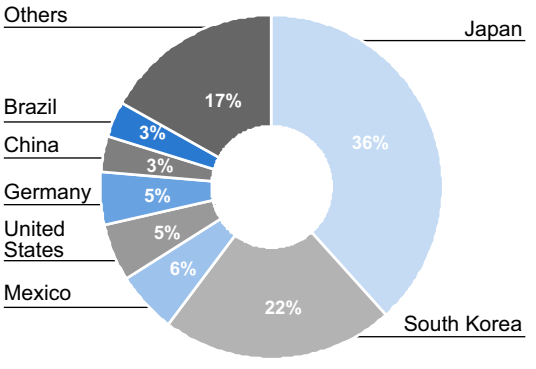
In terms of companies (make), vehicle supply is also highly concentrated **(see Table 2)**. The main importing companies are Toyota del Perú, Nissan Maquinarias (distributor of Nissan and Renault makes) and Automotores Gildemeister (Hyundai distributor), which together represent close to 60% of vehicle supply, all of them new **(see Chart 7 and 8)**.

Chart 5
Vehicle imports (thousands of units)



Source: MTC and Instituto Cuánto

Chart 6
Vehicle imports by origin (2010 up to August, % of total value)



Source: Adex

Table 2
Main vehicle importers (USD millions)

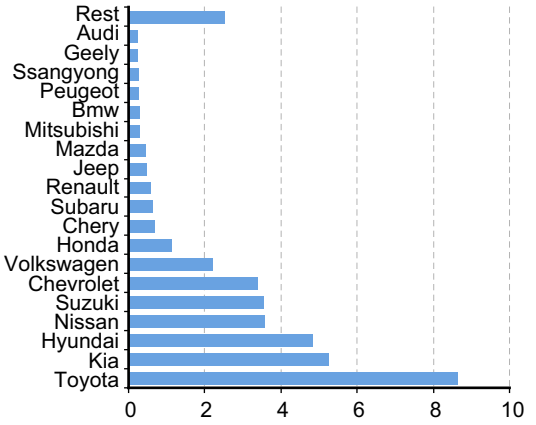
Company	2008	2009	2010*	Part. %2010
Toyota del Perú S.A.	234.0	149.9	202.6	32.5
Nissan Maquinarias S.A.	103.8	93.6	93.6	15.0
Automotores Gildemeister S.A.C	59.1	62.9	67.6	10.9
Kia Import Perú S.A.C	21.1	33.2	39.2	6.3
Euro Motors S.A.	41.0	39.9	38.6	6.2
Soc. Unificada Automotriz del Perú	8.7	39.1	30.6	4.9
Honda del Perú S.A.	41.4	31.1	19.7	3.2
Diveimport S.A.	21.0	21.9	19.6	3.1
Maquinaria Nacional S.A. Peru	30.2	14.8	17.2	2.8
M.C. Autos del Perú S.A.	44.8	19.1	16.4	2.6
Indumotora del Perú S.A.	14.8	12.2	11.3	1.8
General Motors Perú S.A.	1.2	5.6	10.9	1.8
Auto China del Perú S.A.	8.7	5.7	9.2	1.5
Inchcape Motor Perú S.A.	9.6	9.0	8.0	1.3
Motor Mundo S.A.	2.4	6.9	4.8	0.8
Braillard S.A.	5.8	4.2	3.6	0.6
Automotriz Latinoamericana S.A.C.	6.5	1.6	3.2	0.5
Rest	134.9	43.5	26.5	4.3
Total	**789.1**	**594.2**	**622.6**	**100.0**

(*) up to August
Source: Adex

The remaining 40% of supply is distributed among companies that import new vehicles such as Kia Import (distributor of the Kia make), Euro Motors (Volkswagen, Audi, Seat, and Porsche), Honda del Perú (Honda) and Diveimport (Ram, Dodge, Chrysler, Jeep, Mercedes Benz, Freightliner), as well as companies that import used vehicles such as H.A. Motors, Autocraft Perú, Dai Ichi Motors and Fazal Trading, which mainly purchase cars, 4x4 trucks and greater capacity trucks (maximum 16 persons) from Japan. The contrary occurs with car models, quite diversified with around 400 models (70 of these having been introduced in 2010), of which 20% are renewed each year according to sources in the sector.

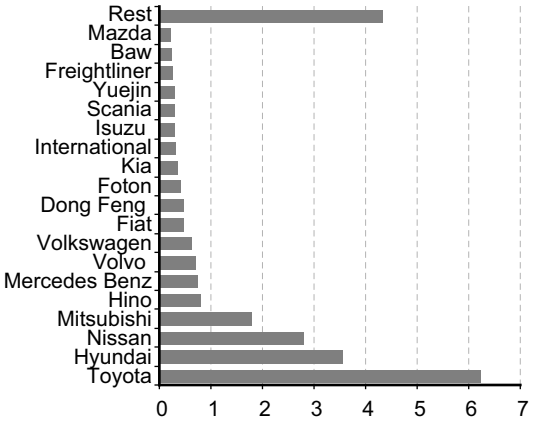
By type of new imported vehicle, light vehicles (family cars, station wagons, family vans, multi-purpose and SUVs) represent 60% of the total, mainly the family models and station wagons, which are used frequently as taxis (many of them later reconverted to run on vehicular natural gas). Commercial vehicles represent 25% of the total, heavyweight vehicles 13% and buses 2%. In general, dynamism is seen in all segments, not only in family-oriented categories, but also in commercial and cargo units which are focused on the needs of large-scale industry as a result of the reactivation of investment projects in 2010.

Chart 7
New vehicle sales (lightweight) by make, Jan-Aug 2010 (thousands of units)



Source: Araper

Chart 8
New vehicle sales (commercial and cargo) by make, Jan-Aug 2010 (thousands of units)



Source: Araper

As for the importation of used vehicles, Peruvian legislation authorizes it for vehicles up to 5 years old, if they are in adequate conditions (not having suffered overturns or debilitating accidents) and if they have the steering wheel on the left. As many of them do not fulfill this third requirement, they are reconditioned in special areas of Peru, an activity which generates around 3,000 jobs between drivers and mechanics, USD 12.6 million annually in salaries and USD 3.6 million in investment, according to Zofra Tacna data.

Used vehicles are imported into the country through ports located in territories that enjoy tax benefits for the carrying out of various industrial, trade and service activities (such as repair and reconditioning of second-hand vehicles). These are known as the Centers for Exportation, Transformation, Industry, Commercialization and Services (CETICOS), and are located in the ports of Ilo (Moquegua), Paita (Piura) and Matarani (Arequipa). A similar area, called Zona Franca (Duty-Free Zone), exists in the department of Tacna (ZOFRATACNA, formerly known as CETICOS Tacna). Presently, vehicles with steering wheels on the right can only come into the country via the ports of Ilo, Paita and Matarani, for subsequent reconditioning.

Under current legislation, the timeframe for the continuation of activities linked to the importation of used vehicles expires in December 2010 in the case of ZOFRATACNA and in December 2012 in the case of CETICOS. Although Congress has been debating a proposal to unify the timeframe for expiry in December 2012 for both types of territories on the basis that the activity benefits the Tacna population in terms of employment generation and income, it stands little chance of being approved. In any case, from 2013 only new vehicles will be allowed into the country, which will boost sales.

It is important to note that a significant reduction in the supply of used vehicles has taken place recently, even before imports of this type of vehicles are finally banned. This is taking place at a time when incomes are higher for consumers, allowing them access to safer vehicles with warranties and better after-sale service, which means that demand is increasingly directed at new vehicles at the expense of the used vehicle market. Consequently, the expansion of the market's supply takes place simultaneously with its restructuring.

Better demand conditions, which are boosting new vehicle sales, are complemented by greater commercialization efforts on the part of sellers. Normally, the commercialization of vehicles in Peru is by way of dealerships, retail sales, and auctions. Companies can act as importers and distributors, and seek to position themselves through promotions, trade fairs (a Motor Show takes place every two years), advertising and institutional agreements with other companies from both the automotive and banking sectors (those participating in the "Expomotor" trade fair). The number of events where the latest versions of vehicles (introduction of new models) are showcased has been increasing in recent years. These events are also larger, more varied in terms of makes and types, and last longer.

Growing demand for new vehicles and the market's potential have led the main makes to increase their investment in the dealership network and sales points in general, in showrooms, and in mechanical and spare part centers. It is estimated that in 2010 this investment will be somewhat higher than USD 20 million.

In short, the supply of new vehicles is proving flexible enough to adapt to the requirements of the Peruvian consumer and thereby meet the expected growth in demand. In addition, losses traditionally attributable to the supply of used vehicles will diminish over the medium term.

Auto parts

In this context of a growing vehicular fleet in Peru, a similar trend is observed with regard to the spare parts market, which is composed of genuine and alternative spares for light vehicles, trucks, buses and other industrial applications. This sector grew by 40% during the first half of 2010.

The market is supplied both domestically and from abroad. Dynamism is seen in both: local production increased at an average annual rate exceeding 30% in recent years, while spare part imports grew by over 40% (imports increased to USD 400 million in 2009). The latter were mainly made up (about 60%) of three types of products: wheels, tires, and inner tubes; motors and their components; and other parts **(see Table 3)**.

Table 3
Imports of auto parts (USD millions)

Product	2008	2009	Part. % 09
Wheels, tires, and inner tubes	138.6	115.2	29.1
Motors and components	104.1	80.0	20.2
Other parts	47.6	53.0	13.4
Brakes, clutches and their components	28.4	24.9	6.3
Drive shafts	19.2	17.4	4.4
Shock absorbers	16.2	12.9	3.3
Bodies and parts	18.8	33.6	8.5
Batteries	21.0	17.4	4.4
Gear boxes	8.5	12.0	3.0
Heating units, air conditioning units, and their components	13.8	11.5	2.9
Axes	4.8	4.0	1.0
Glass windows and mirrors	7.3	7.1	1.8
Steering wheels, shafts, and boxes	1.3	1.2	0.3
Seats	1.0	0.7	0.2
Radiators	3.7	3.7	0.9
Silencers and exhaust pipes	0.7	0.9	0.2
Total	**434.8**	**395.5**	**100.0**

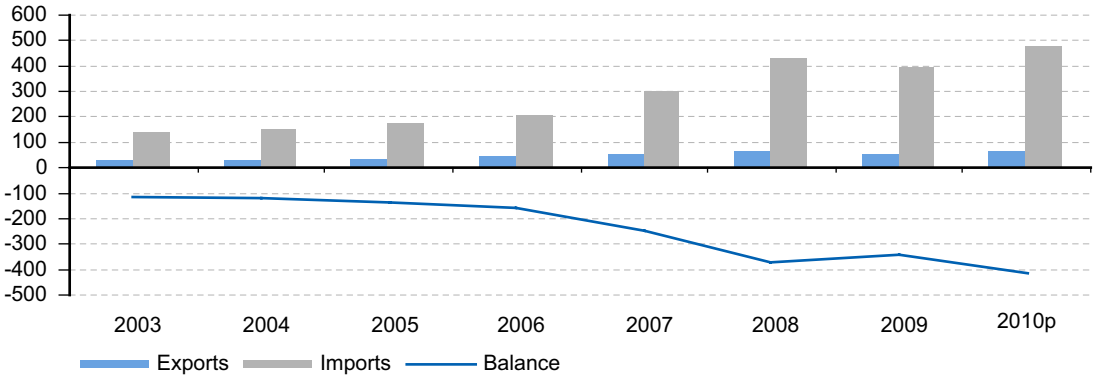
Source: Sunat

The main source markets for the purchase of auto parts are China, Japan, South Korea, India and Brazil, countries whose products make up 75% of imports in this area. This supply is intended mainly for the mechanical repair and spare part industry, given that Peru has no domestic vehicle production. In addition, auto parts are exported for assembly abroad. The commercial balance has been increasingly negative in recent years **(see Chart 9)**.

Motores Diesel Andinos, Comercio & Cía., Michelin, Compañía Goodyear del Perú and Tire Sol are the largest commercialization companies. Concentration in the industry differs by product, with higher levels in the wheel, tire, inner tube, body and brake markets, where the five largest companies account for about 50% of the market, and substantially less concentration in engines. Thus, and according to the consultancy Maximixe, the profit margins of a company offering genuine parts can be up to 25%, compared to 10% in the maintenance parts sector.

It should be noted that although the importation of used spare parts is prohibited by the Ministry of Transport and Communications, these were coming in anyway due to legal rulings in favor of importing companies. The Tribunal Constitutional has called for these rulings to be rejected, but preventive measures have been taken that have made the entry of used parts possible.

Chart 9
Auto parts trade balance (USD million)



Source: Sunat and BBVA Research Peru

Because it is foreseen that the automotive fleet will continue to expand over the coming years at rates higher than 30%, the outlook for the parts market is also positive. Still, the entry of used auto parts can endanger market growth.

3. Demand for vehicles

As mentioned in the previous section, vehicle supply adapts to demand. Thus, new car sales have increased steadily in recent years **(see Chart 10)**, showing an elasticity of 4.6 points in relation to GDP in the last growth cycle, 2002-2008. Since 2005, an average annual expansion of 37% has been observed in the number of new units bought, and the reduction in 2009 (-17%) linked to the global economic crisis was followed by a significant recovery, exceeding 50% so far in 2010. So we estimate that annual vehicle purchases in Peru will reach about 120,000 units in 2010. This demand growth rate is greater than expected, which is reflected in the difficulties seen in some cases to meet it. For example, buyers must wait in some cases several months for the delivery of the car.

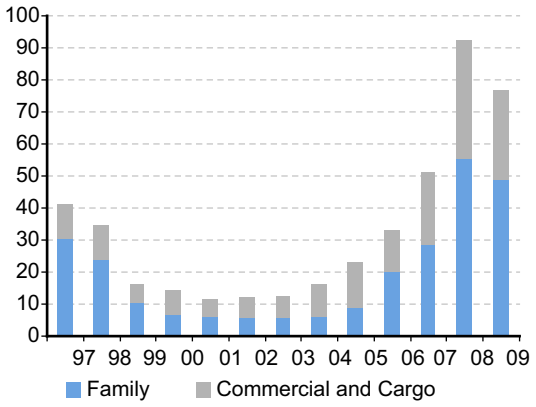
This evolution of new car sales has taken place in an setting of i) economic growth, ii) greater competition between makers (over 60 formally registered makes) which is putting downward pressure on prices and iii) access to lower-priced fuels. This has boosted sales of light vehicles (linked to consumption) as much as commercial and cargo vehicles (linked to investment). On the one hand, the number of light vehicles has increased sevenfold since 2003, in keeping with greater purchasing power by households and increased consumer confidence. On the other hand, commercial and cargo vehicles tripled over the same period as a result of increased demand from companies in the mining, commerce, agro-industrial and manufacturing sectors, in keeping with the execution of large private investment projects and greater business confidence.

On a regional basis, Lima is where most new cars are sold (80% in 2009 according to Araper). However, the share of other provinces has been growing in recent years, especially in cities such as Arequipa, Trujillo, Chiclayo and Cusco.

Although it presents a remarkable evolution, the flow of vehicle purchases in Peru is still small compared to that of other markets. To illustrate, while in 2008 three vehicles were bought per thousand inhabitants in Peru, in a market of comparable average income like that of Colombia purchases were almost 70% higher **(see Chart 11)**. This suggests that there is room for the dynamism of demand to be maintained in the medium term.

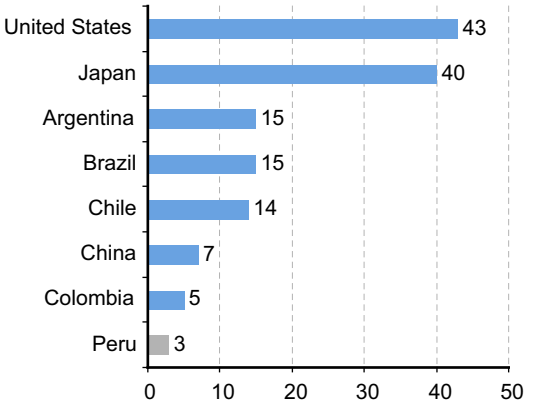
IIncreased demand on the part of the average consumer in the Peruvian automotive market is aimed mainly at the purchase of small and low-priced cars, in particular sedans, of between 1000 and 1500 cubic centimeters, priced between USD 12,000 and USD 15,000. Against this backdrop, of particular interest is the increased number of purchases in the juvenile sector, where vehicles adapt to these characteristics with relatively low prices (between USD 11,500 and USD 13,500). Something similar is seen in car makes displaying greater dynamism, among which Chinese makes stand out, also as a result of their low prices. The luxury segment (between USD 45,000 and USD 150,000) is also evolving in a remarkable way, with increasingly young clients (from 35 years) and already representing between 5% and 10% of total sales.

Chart 10
New vehicle sales (thousands of units)



Source: Araper

Chart 11
New vehicle sales in 2008 (vehicles per 1,000 people)



Source: Bloomberg and IMF

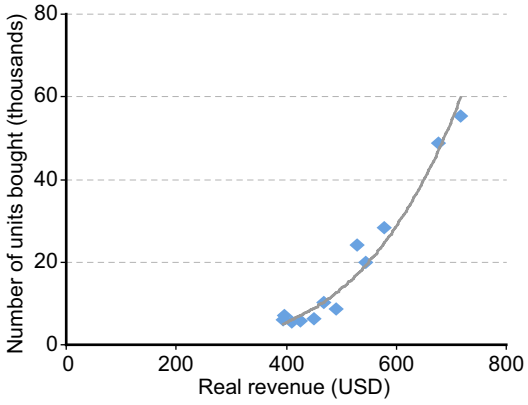
Determining factors in demand

The first factor supporting increased demand for vehicles is the increase in household income. Since 2005, economic activity has grown at an average annual rate of nearly 7%, which has encouraged employment generation and the increase of income at an average annual rate of 8.5%. As shown in **Chart 12**, the increase of household income has been accompanied by a greater demand for new vehicles by these families. This is complemented by the strong growth in investment in the country and the expansion of sectors such as mining, construction, and commerce, which has boosted purchases of commercial and cargo vehicles mostly by companies.

In addition to the higher average income of the population, the number of families now able to afford a new vehicle has increased. For instance, over the last five years, the share of the population belonging to the high and medium income socioeconomic sectors, i.e. sectors A, B, and C, increased by 10 percentage points, as seen in **Chart 13**. Economic growth and increased employment (which is growing in the formal sector) have boosted the expansion of the size of the potential automotive market, not only due to the aforementioned increase in income, but also because these households (those of sector C in particular) enjoy easier access to bank financing and perceive a more stable situation, leading them to spend more on durable goods.

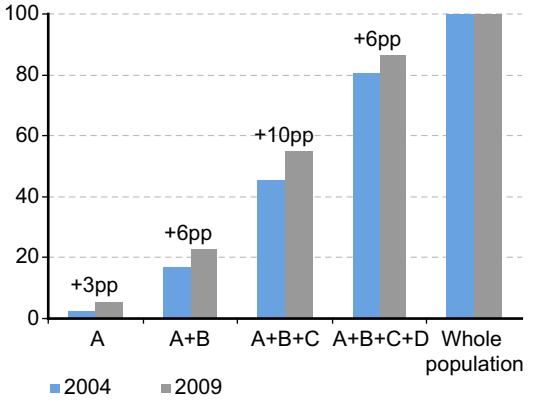
Considering that economic activity in Peru should grow over the coming years at an average rate of 6% annually even as informal employment is being reduced, rising household incomes as well as the greater density of the population sectors who have access to vehicle financing and the acquisition of new cars will continue to enhance the dynamism of the automotive market. In addition, it should be noted that only 10% of Peruvian households reported that they owned at least one car **(see Table 4)**, a low percentage compared with other countries such as Chile, where this figure is 29%. This expansion should not be limited to automobiles –the demand for which is associated more clearly with private consumption– but, given that economic growth over the coming years will be sustained mainly through investment, it is hoped that the demand for commercial and cargo vehicles will also display a favorable evolution.

Chart 12
Household income and new family vehicle purchases



Source: Apoyo Opinión y Mercado, ARAPER

Chart 13
Structure of the population by socio-economic level (% of population)



* Socio-economic level A corresponds to the highest income level
Source: Ipsos Apoyo.

Table 4
Car ownership by homes

Cars per home	Gross income (average)	Households	% of homes
0	17,139	6,483,636	90.5
1	50,183	594,221	8.3
2	85,302	67,714	0.9
3	135,295	11,196	0.2
4	194,588	2,738	0.0
5	211,668	558	0.0
8	92,619	587	0.0
Total	**20,800**	**7,160,649**	**100.0**

Source: National Households Survey, 2009. Compilation: BBVA Research Peru

A second factor that has been boosting vehicle purchases is the increasing attractiveness of prices. On the one hand, greater competition in the automotive sector, driven by the entry of low-cost makes such as Chinese ones (the price of a Chinese vehicle can sometimes be 15% less than that of established makes), is leading sellers in general to offer vehicles with greater facilities and at more accessible prices. The behavior of the customers themselves, more informed and detail-oriented than in the past, is causing this increased competition. Thus, the growing new demand, in particular by consumers who for the first time can think of buying a car, has found a space in the market ready to serve it. Another factor is the strengthening of the local currency which, having appreciated a total of 20% over the last five years, has also boosted the quantity of vehicles demanded, as their prices are usually set in dollars.

Greater tax incentives have also had a positive effect on prices and consequently on the demand for new vehicles. Up to September 2007 a duty of 12% was imposed on the import of vehicles, together with a selective consumption tax (ISC in Peru) of 10% and 19% in VAT (IGV in Peru) to buy a new vehicle. Since October 2007, the duty was reduced to 9% and in December of the same year the ISC was eliminated for the purchase of light vehicles using gasoline, liquefied petroleum gas (LPG), or vehicular natural gas (VNG). In the particular case of vehicles considered as capital assets (trucks and pick-up trucks), the import duty was eliminated in 2006. In addition, the coming into effect of the free trade agreement with the United States in February 2009 eliminated tariffs on new vehicles coming from that country with engine sizes exceeding 3,000 cc, while for vehicles with smaller engine sizes the reduction will be gradually introduced over the next eight years. In this way, the reduction of taxes and tariffs has helped reduce the price to be paid by the consumer and placed the automotive market within reach of a greater number of families.

It is foreseen that vehicle prices will remain at levels that facilitate access to the automotive market by the population. This is based on the fact that greater competition will tend to be seen between auto makers when the free trade treaties with the European Union, Japan and South Korea come into

effect. Furthermore, the decreasing value of the exchange rate foreseen for the coming years will push prices in the same direction.

A third factor that is beginning to have a positive impact on demand for vehicles is access to lower-priced fuel. We are seeing an increasing number of new vehicles with engines reconverted from those employing gasoline to those allowing the use of vehicular natural gas **(see Table 5)**. This is due to the fact that one gallon of vehicular natural gas is approximately 50% cheaper than a gallon of gasoline. For this reason, in spite of the relatively high cost of conversion (equivalent to about US$800 for cars), 900 new vehicles are reconverted to vehicular natural gas every month. The attractiveness of this fuel is an incentive for the extension of the network of stations capable of delivering it, which will provide access to the automotive market by a growing segment of the population.

Table 5
Development of the vehicular natural gas market

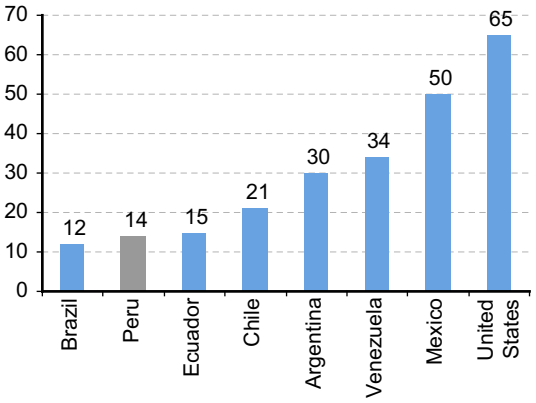
	Dec-08	Dec-09	Aug-10
Converted vehicles	57,419	81,029	95,242
Conversion workshops			
Operating	140	180	200
In process	3	2	1
Public sales establishments of VNG			
Operating	57	94	126
In process	23	33	37
Consumption in cubic meters per day	10.76	10.44	10.62
Accumulated sales in millions of cubic meters	184.4	483.4	981.1

Source: Cámara Peruana del Gas Natural Vehicular (Peruvian Chamber for Vehicular Natural Gas)

On the other hand, it is important to mention that the public transport service provided by both buses and taxis (approximately 26,000 and 220,000 units respectively) in Lima and Peru in general is very disorganized, informal (90% according to sources in the sector) and of low quality. The lack of regulation reflected in the outsourcing of the vehicular fleet by urban transport companies, which does not permit adequate labor conditions for its operators (drivers and conductors), as well as the absence of any planning of the transport routes by municipalities, has led to an excess of public transport supply (for instance, in Lima there are 26.92 taxis for every 1,000 people, compared to 8.91 in Santiago), with fierce price competition (also called the “penny war”) and a lack of customer service in all other aspects. To tackle the weaknesses of public transport in the capital, the Executive and the municipal authorities of Lima have undertaken significant investments in infrastructure, including the electric train and the system known as the rapid transit bus scheme (also called Metropolitano). Sources in the sector, however, warn that these two projects would alleviate the problems of less than 15% of the number of passengers transiting through Metropolitan Lima, and are therefore insufficient. Given this situation, as long as the quality of the public transport system does not improve (the population identifies it as the second main problem in the capital), there is a clear incentive for a population with more income, seeing better prices, and with more access to financing to buy private vehicles.

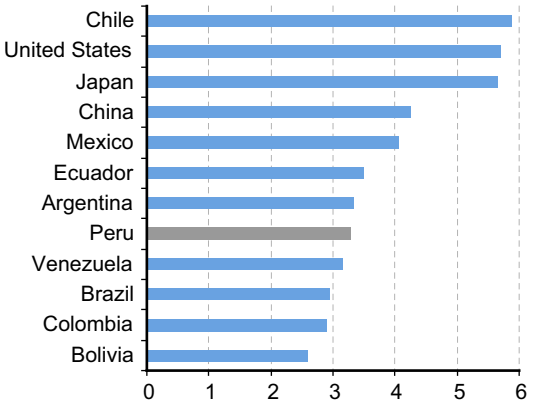
Finally, in terms of the road infrastructure in the country, paved roads continue to account for a relatively low percentage of the entire road network in the territory. As seen in **Chart 14**, in this respect Peru is lagging behind at the regional level, and in general the quality of its road infrastructure is low **(see Chart 15)**. This, among other things, represents a hindrance for the development of the automotive market. For this reason, in recent years the government has been boosting public spending through investment and launching various schemes to close the road infrastructure gap which according to the Instituto Peruano de Economía (Peruvian Economic Institute) amounts to 5.8% of GDP or USD 7.4 billion. Information from the Organismo Supervisor de la Inversión en Infraestructura de Transporte de Uso Público (Supervisory Board for Public Transport Infrastructure Investment) shows that 14 contracts have been awarded for road infrastructure development for an amount of approximately USD 3.4 billion. This is just under 50% of the estimated road infrastructure investment gap. The projects include the Interoceánica Sur (south inter-oceanic road), stretches 1, 2, 3, 4 and 5; the Interoceánica Norte (north); la Interoceánica Centro (center), stretch 2; Red Vial (road network) 4 (Pativilca-Puerto Salaverry); Red Vial 5 (Ancón-Huacho-Pativilca); Red Vial 6 (Pucusana-Cerro Azul-Ica); and the Autopista del Sol Trujillo-Sullana highway. The completion of these projects will facilitate commercial communication between local production centers and distribution centers, as well as tourism, which will boost demand for light, commercial and cargo vehicles.

Chart 14
Paved roads (% of total road network)



Source: IPE and various sources

Chart 15
Quality of road infrastructure (grading: 6 = efficient)



Source: The Global Competitiveness Report 2010-2011

For this reason, in recent years the government has been boosting public spending through investment and launching various schemes to close the road infrastructure gap which according to the Instituto Peruano de Economía (Peruvian Economic Institute) amounts to 5.8% of GDP or USD 7.4 billion. Information from the Organismo Supervisor de la Inversión en Infraestructura de Transporte de Uso Público (Supervisory Board for Public Transport Infrastructure Investment) shows that 14 contracts have been awarded for road infrastructure development for an amount of approximately USD 3.4 billion. This is just under 50% of the estimated road infrastructure investment gap. The projects include the Interoceánica Sur (south inter-oceanic road), stretches 1, 2, 3, 4 and 5; the Interoceánica Norte (north); la Interoceánica Centro (center), stretch 2; Red Vial (road network) 4 (Pativilca-Puerto Salaverry); Red Vial 5 (Ancón-Huacho-Pativilca); Red Vial 6 (Pucusana-Cerro Azul-Ica); and the Autopista del Sol Trujillo-Sullana highway. The completion of these projects will facilitate commercial communication between local production centers and distribution centers, as well as tourism, which will boost demand for light, commercial and cargo vehicles.

4. Prospects for the future

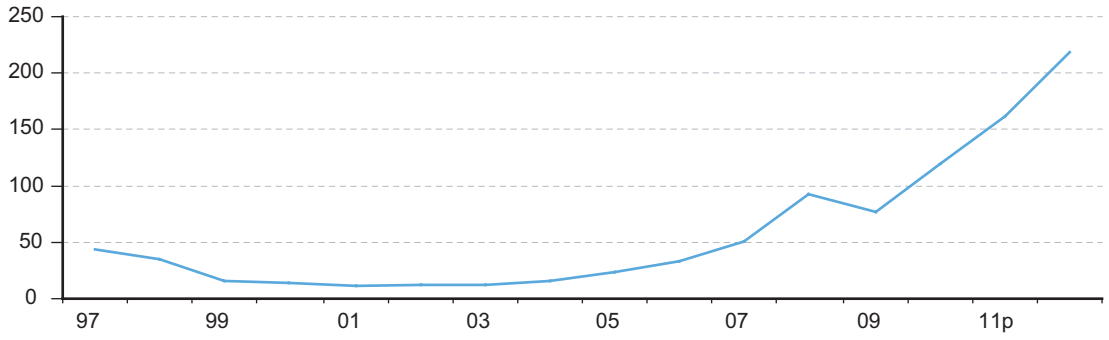
Prospects for the Peruvian automotive market are quite positive for the short and medium term. Thus, after suffering the effects of the global economic crisis, a clear growth impetus will resume in 2010 (in excess of 50%), a dynamism that will continue over the next two years at around 35% annually (**see Chart 16)**. The number of new vehicles sold annually on the market should therefore reach 220,000 units in 2012. This forecast assumes that the supply of new vehicles will be able to keep up with the increase in demand.

A key factor supporting our forecasts is the starting state of the Peruvian automotive fleet. In spite of its rapid growth in recent years, its size is still relatively small compared to other countries in the region, including after adjusting data for income differences. Another factor is its old age, which in a context of favorable conditions for supply and demand could prove to be another boost in terms of renewal of the existing fleet. Finally, its concentration in the capital city leaves room for growth in the rest of the country.

On the demand side, the average income of Peruvian households is expected to grow significantly over the coming years, along with the foreseen expansion of local economic activity, and the population segments which can afford to buy a vehicle will continue to grow. In addition, prices are set to remain attractive, in a context of a strong local currency and lowering of import tariffs (coming into effect of new free trade treaties).

The supply of vehicles, consisting solely of imports, will in general continue to adapt to demand conditions. Increased potential demand will lead to an expansion of the dealership network, and the greater opening of the economy will increase competition between makes in the automotive market. Vehicle supply will not only increase, but will also be reshaped when imports of used vehicles come to an end in 2013.

Chart 16
Demand for new vehicles (thousands of units)



Source: ARAPER and BBVA Research Peru

The main risk identified is possible pressures to extend the facilities for the importation of used vehicles beyond 2012. However, this would have a limited effect on the balance because the forecast improved economic environment should boost demand for new vehicles. An additional risk limiting the growth of the vehicular fleet is infrastructural restrictions in road networks and parking that can cause traffic jams and economic losses in terms of man-hours and household income.

5. Financing

Interesting opportunities are presenting themselves in terms of financing for the purchase of vehicles as well. This is linked to the forecast evolution of supply and demand in the automotive market for the coming years, but also to the current situation of the credit market for these operations, which leaves room for significant development.

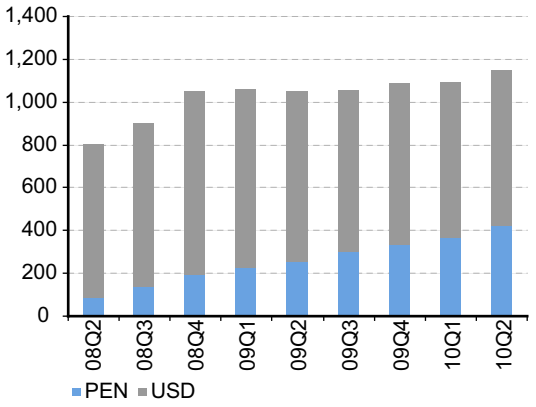
Firstly, the expected growth of the vehicular fleet will imply an increase in financing needs. This will not only come from those seeking to buy a car, but also from companies in the sector which buy new cars to resell them or those engaged in repair activities. The balance of credits to these companies was PEN 2.082 billion at the end of the first half of 2010 (USD 744 million). Current low levels of vehicle inventory and the aforementioned expansion plans of dealers constitute a support on the short and medium terms for investments in this sector.

Secondly, although the trend is positive (20% of average annual growth over the last two years in spite of the crisis), at the closing of the first half of 2010 the balance of credits granted by banks for the (final) purchase of vehicles was PEN 1,146 million **(see Chart 17)**, or just over USD 400 million, i.e., 1.2% of total bank credit and 0.3% of GDP. This penetration is relatively low if we consider that only one in five new vehicles would be financed by bank credit **(see Chart 18)**, which leaves room to grow.

This situation has led to a more aggressive stance by financial entities to attract a larger part of the potential market, which has translated into greater competition benefiting the consumer. In this context, for example, the borrower now has greater leeway for negotiating the interest rate and the payment is made faster, in particular for those who receive their salaries at the financial institutions. Furthermore, the service provides the possibility of buying vehicle insurance under advantageous conditions (in installments and with no interest).

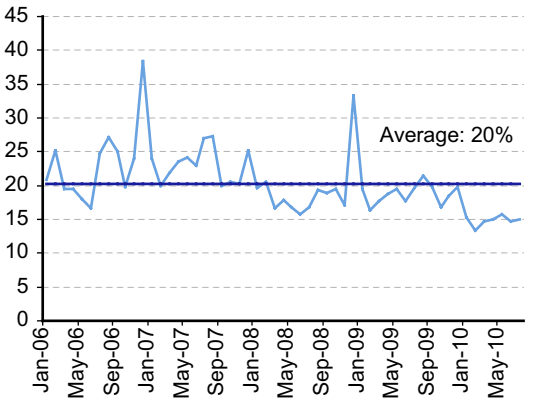
It should be mentioned that about nine institutions in the banking system currently offer car loans. Four of them account for 95% of the total value of these credits. BBVA has the greatest share with 39%, followed by BCP with 27%. The two institutions that follow are Interbank and Scotiabank Perú, which hold 19% and 10% of the total value of car loans, respectively **(see Chart 19)**. Interbank showed the greatest dynamism over the last year.

Chart 17
Car loan balance (PEN million)



Source: SBS

Chart 18
Financed vehicles (% of total sales of new cars)



Source: Araper

Most car loans granted are for the purchase of new cars and enable financing of up to 80% of the car's value (i.e., the minimum down payment is 20% of the car's value), although some institutions grant financing for up to 100%. The average amount paid in credit is over USD 14,000 **(see Chart 20)**. This might reflect the increased purchasing power of households, which leads them to demand higher-quality cars, and takes place in spite of the greater access to financing by medium-income households, which purchase increasingly inexpensive vehicles. The maximum repayment period for car loans is 5 years (60 months), although the average period is 52 months, while the average monthly installment is between USD 250 and USD 300. It is possible to make extra payments in July and December (extra installments) and pre-payments.

As for the currency used for car loans, at the close of the second quarter of 2010, 63% of the amount loaned was denominated in USD, and the rest in the PEN. The interest rate for loans in USD is around 9%, and somewhat higher for loans in PEN. Recent trends show that the share of PEN loans in the credit portfolio is increasing, which is appropriate as it reduces the exchange rate risk. This lower exchange risk and the favorable economic environment have resulted in a low default rate on vehicle loans (less than 2%), helping interest rates to remain at attractive levels.

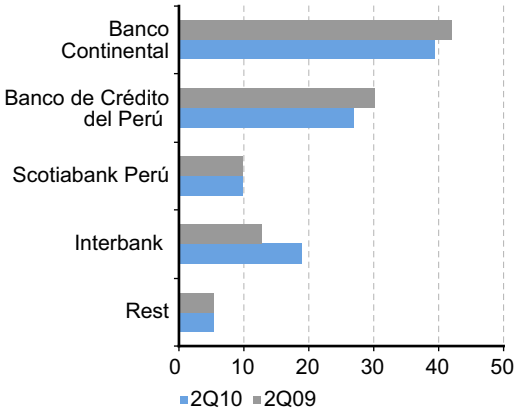
The aggressiveness of banks is also a result of growth in vehicle financing competitors, including collective funds. Collective funds involve grouping together between 60 and 180 people who pay a monthly installment (for five years) to finance the purchase of the new vehicles that are later distributed among the group's members. According to sources in the sector, these collective funds handled USD 114 million at the close of the first quarter of 2010, or 30% of the car loan balance, and are set to pay for 3,500 new vehicles in 2010 (a 26% increase over 2009). There are four collective fund companies: Pandero, Maquisistema, Opción and Fonbienes.

Thirdly, there is also potential for car loan growth for vehicles sold in the second-hand market. According to official information there are 260,000 such transactions per year, i.e., more than twice the number of new units sold. Banks do not have significant penetration in this sector, especially larger banks, and only some of the institutions more focused on consumer loans are starting to meet the demand in this sector.

To summarize, the low penetration of credit in the new vehicle market, the possibility of extending the operations to the second-hand market, the prospect of fast growing supply and demand in the automotive sector, and the interest shown by financial institutions all strongly suggest an expansion of car loans over the years to come.

Chart 19

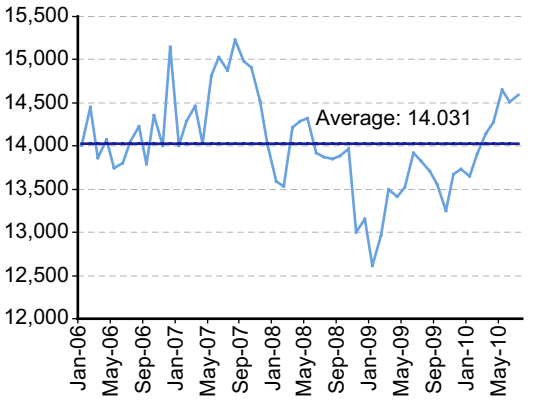
Share of vehicle credits (%)



Source: SBS

Chart 20

Average vehicle loan (USD)



Source: Araper

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