

# Motor Vehicle Outlook

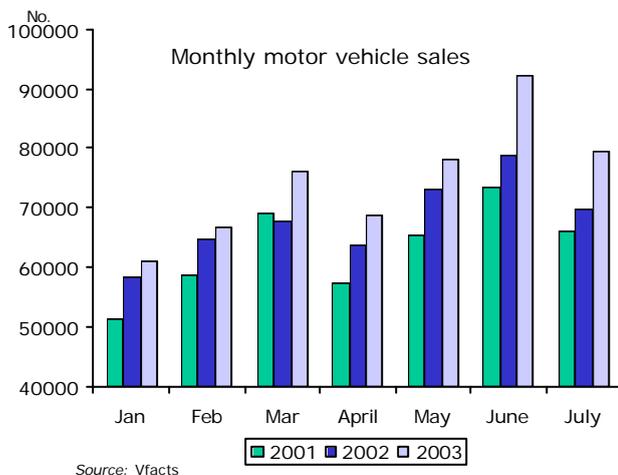
## Sales go berserk

New motor vehicle sales reached a record high in June causing industry participants and outside forecasters (including this one) to scramble back to the drawing board. Initial forecasts for new motor vehicle sales in 2003 have been sadly astray. If the figures to June caused embarrassment, the just released July figures are enough to give forecasters apoplexy. While a relatively strong domestic economy is underpinning sales, economic growth alone, can't explain the strength of this market. Sales for 2003 will easily eclipse last year's record.

### Forecasts astray

At the beginning of the year motor vehicle producers and industry forecasters were expecting new motor vehicle sales to equal or fall back from the record of last year. Strength in sales in the early months of the year led to a lift in sales forecasts for 2003. The Federal Chamber of Automotive Industries raised its forecast to 850,000 in May and following the staggering June result, lifted the figure again to 875,000. Monthly sales in June were 92,080 vehicles, easily eclipsing the previous record of 84,470 set in June 1999. At the end of June, motor vehicle sales were running 8.9% ahead of the corresponding months of last year. If that rate was maintained for the rest of the year sales would reach 898,000.

### Sales boom in 2003



Given the strength of June and the return to more seasonal patterns following the passing through of the distorting effects of the GST on business purchases, July was expected to be weaker. Indeed, sales were lower in July than June, but this reflected the normal monthly movement. In fact, sales were very strong for July, being 14% ahead of sales in July 2002. This lifted the growth in sales over the year to the end of July to 9.6%. The July figures are enough to give forecasters and those striving to explain the market apoplexy. Not only do they have to explain why the market has grown strongly after the record set in 2002 but also to explain why sales are accelerating as the year progresses.

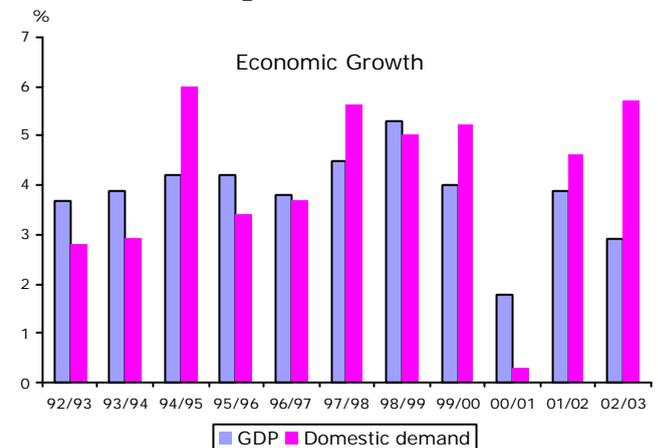
As mentioned in previous Motor Vehicle Outlooks, no economic variable provides a neat co-relation with motor vehicle sales. Economists are forced to rely on 'economic intuition' in determining the direction and level of sales. Paramount in this 'intuition' is an analysis of the health of the economy, particularly the rate of economic growth. This is then modified by analysis of exchange rates, credit growth, interest rates and government policies. On top of this, is layered knowledge of the market, changes in the tastes and preferences of consumers and developments in other sectors of the economy.

So what's been happening in the economy?

### Economic growth remains strong

Economic growth slowed in 2002/03 but most of this was due to weakness on the external side of the economy. On our forecasts, domestic final demand, which reflects the health of the domestic economy, grew at 5.7% - the fastest rate since 1994/95.

### Strong domestic demand



Domestic economic growth has been stronger than expected. In particular the construction boom, especially in housing, has lasted longer than most forecasters predicted. In conjunction, the acceleration in house prices has been stronger than anticipated and the expected fall so far non-existent. Many economists underestimate the importance of the housing sector on the Australian economy. Its impact is out of all proportion to its share of economic activity. A booming housing market has widespread secondary impacts on the

Australian economy. It provokes a good feel effect throughout the household sector. So is it any wonder that despite the warnings from official sources and economists about the overheated housing market, consumer confidence is close to record highs? There have been few negatives on the domestic front. Government policy has erred on the expansionary side as an insurance against the impact of a weak international economy on the Australian economy.

In short, domestic economic growth has been stronger than anticipated providing a healthy underpinning for motor vehicle sales.

However, the rate of economic growth has been slowly decelerating suggesting that the rate of growth of car sales would do likewise. While sales of new motor vehicles to private buyers can lag the economic cycle, this is not usually the case in sales to business. Economic intuition would suggest that motor vehicle sales would slow as 2003 progressed or at least would flatten. The fact that sales are accelerating suggests that factors other than economic growth are driving this market.

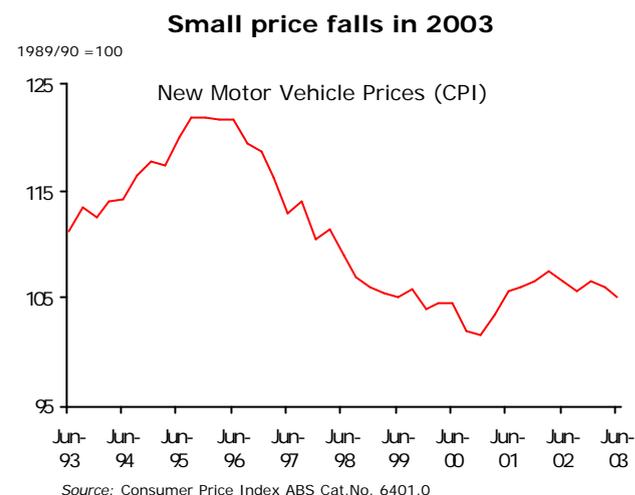
### What could they be?

Changes in the value of the Australian dollar (A\$) against other currencies can at times (as in the mid – 1980's) have a big impact on new car sales. Since the beginning of the year, the A\$ has appreciated against most currencies, rising 15.6% against the US dollar. Against important source countries for motor vehicles, it has appreciated 16.1% against the Japanese yen, 13.9% against the Korean won and 7.6% against the Euro. The impact of these movements is not clear-cut. It depends on whether the foreign company invoices in the local currency or in \$US dollars, as well as the hedging in place to protect against currency fluctuations. However, as a general rule, given the large share of the domestic market held by imports, an appreciation of the \$A dollar should be favourable for the market.

Unfortunately, as for other variables the link between exchange rate movements and retail prices is not automatic. Currency movements can change quickly and hence producers are often reluctant to immediately change prices. Importers may absorb the benefits of the exchange rate movement into their margins, rather than pass them on in the form of lower prices at the retail level. Much will depend on the extent to which importers margins have been squeezed in the past by the low exchange rate, the level of competition and existing price deals at the retail level. After all these caveats, is there evidence that exchange rate induced lower prices have been the key factor driving the market?

Car prices as measured by the consumer price index fell in the June quarter suggesting that an

appreciating Australian dollar might be exerting a downward pressure on prices. However, it is difficult to get excited by this factor as the key driver of sales. Allowing for the distorting effects on new car prices of the removal of wholesale sales tax and its replacement with the GST, prices at the retail level have remained relatively flat since 1998 despite gyrations in the value of the \$A dollar. At the retail level, price positioning, in a keen and competitive environment, appears a more important factor than the exchange rate.



Strong growth in incomes could be a candidate.

There is some support for this theory in business purchases of new motor vehicles. Sales of passenger motor vehicles where business fleet purchases are important have been strong after a rather flat 2002. More importantly, sales of trucks, which include utilities, have been going gangbusters for the second year in a row. Try finding an old Ute on a construction site. Even in rural Australia, despite the drought, there is plenty of anecdotal evidence of the buying of late model Utes. Profitability and cash flow in the business sector has been strong. As a consequence, many firms are cashed up but due to uncertainties stemming from external events, have been reluctant to commit to new capacity. Motor vehicles have filled the need for this investment void.

However on the consumer side there is little to get excited about. Wages growth has been moderate and much of the new employment created has been in part-time jobs. So what could be propelling consumer sales?

Interest rates have remained low and credit growth has been strong. Household demand for credit has been growing at around 20%, well in excess of household income growth. Access to cheap and readily available finance to purchase new motor vehicles has been available. Consumers have the

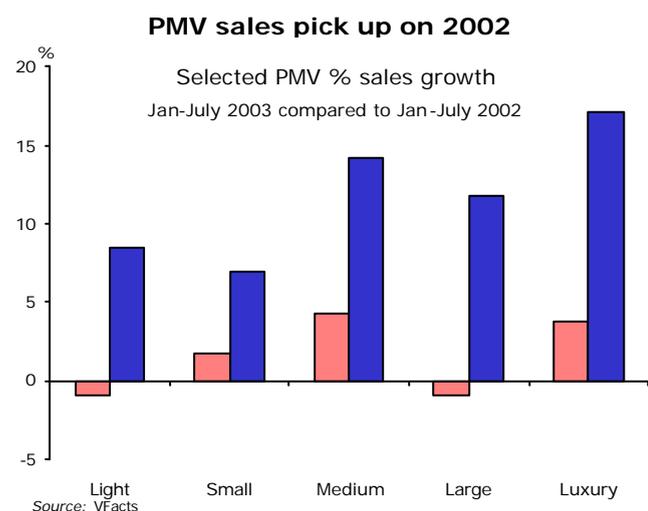
good feel effect of rising wealth on the back of increased house prices. Rising levels of household debt attest to newfound confidence in the debt habit by some sections of the household sector. Consumers have been unlocking wealth in their own homes by borrowing against existing equity. While most of this appears to be for further investment in real estate, housing equity withdrawal continues to support consumption and economic growth.

With high levels of consumer confidence and a good feel effect permeating the market all that is required is enticing product. The range of vehicles available across the price spectrum is broad. Quality is generally high and the range of options prolific. Simply, the required product is available.

In short, the only reasonable explanation for the strength of the market is that Australians fuelled by an asset boom in the housing market are in party mood. Now is a good time to replace that tired out vehicle. Despite repeated warnings about the economic vulnerability of many households and the destabilizing economic and financial nature of asset booms and busts, few Australians are listening. Why listen to some party poopers in Canberra or Sydney when you're having a good time?

### Segment and State sales growth

Following exceptional growth in 2002, sales of sports utility vehicles (the old all terrain wagons) have been strong. However the star performers have been light trucks and heavy trucks.



After adjustment for official reclassification between light and heavy trucks, in the first seven months of this year, sales of light trucks are 16% and heavy trucks 17% above the corresponding period of 2002.

A notable feature of last year's market was the relative poor growth performance of passenger motor vehicles. However, in the first seven months

of this year sales of these have been much stronger than the corresponding period of 2002. Sales have been boosted by renewed fleet buying by business, propelled by the release of new models in the large six-cylinder car market. But, sales have also been stronger at both the bottom and top end of the price spectrum, exemplifying the strength and depth of this market.

Sales growth in all states was stronger in the first half of this year compared to the first half of 2002. There was some variation in the strength of growth. Sales in South Australia and Queensland were strongest while sales growth lagged in NSW.

### Sales growth strong in S.A. & Queensland



### So where does all this lead us?

Clearly sales for 2003 will be an all time record. On present figures over 900,000 but on our forecasts more like 870,000. Economics @ANZ is forecasting weaker domestic demand as this financial year proceeds. There will be some lagged impact on the motor vehicle market. However, based on economic indicators we should see a slowing of the market in the last months of 2003 followed by a weaker 2004. But there are no guarantees. The market has proved industry participants and economic forecasters wrong this year and may continue to do so. The latest Reserve Bank warning that the longer the boom in the housing and debt markets continue, the more severe the correction in the real economy is likely to be, continues to fall on deaf ears.

As the great economist, John Maynard Keynes, once observed – in the long-run we are all dead. As such, we might all do well to open the champagne and join the party before the inevitable shower- unless you believe the economic cycle is dead.

Pass me the umbrella Fred.

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