

## Positive outlook for motor vehicle sales and Australian vehicle production in 2007-08

07 September 2007

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## Our Vision:

For Economics@ANZ to be the most respected, sought-after and commercially valued source of economics research and information on Australia, New Zealand, the Pacific and Asia.

This report is part of a twice-yearly series that analyses emerging trends in the Australian market for new motor vehicles. The last issue was released in February 2007.

## Key points

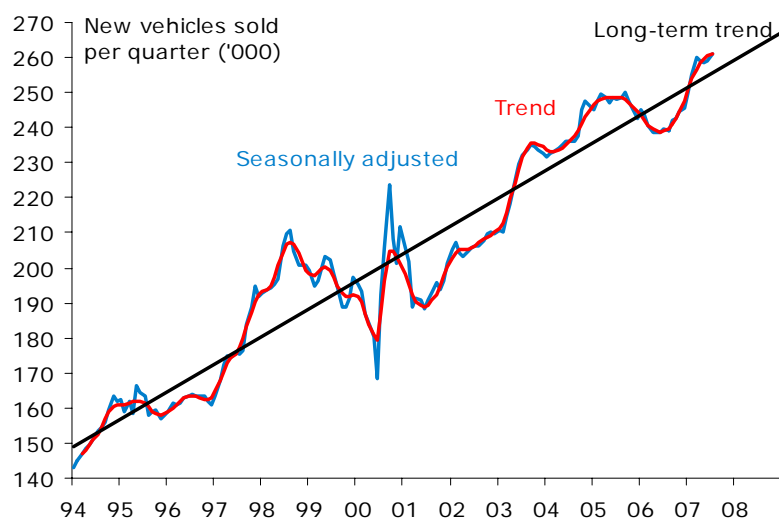
- Total new vehicle sales for 2007 thus far (Jan-Jul) are 8.9% higher than for the same period in 2006.
- 2007 sales have lifted for all vehicle segments, with sales of SUVs performing most strongly. After hitting the magic million in financial year 2006-07, total annual sales will remain at high levels in 2007 and 2008.
- Australian-made vehicles continue to lose market share locally, although the prospects for improved export sales are good.

## Recent sales trends

If recent sales figures are anything to go by, now is the time to buy a new car. After falling by 2.6% in 2006, total sales of new motor vehicles have rebounded strongly, up 8.3% in the first half of 2007 compared with the same period last year. In annual terms, sales topped the 1mn mark for the first time in the year to the June quarter 2007.

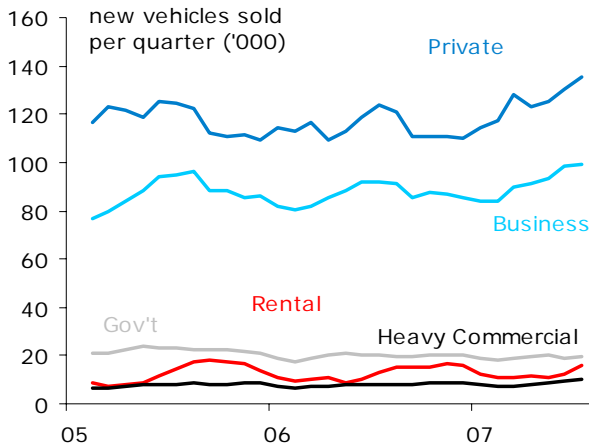
The trend toward smaller and more fuel efficient cars evident since 2005 continues unabated, with sales of these vehicles increasing 6.7% in the year to July 2007 compared with the same period last year. Sales of medium cars jumped 10.6% over the same period. In contrast, sales of large and upper large cars were broadly flat, down 0.5%. The trend toward smaller cars is also apparent in the sport utility vehicle segment of the market, with sales of compact SUVs up a staggering 16.6% over the year to July. Commercial vehicle sales have also been strong, up 6.7% thus far in 2007 compared with the same period a year ago.

## Long-term trends in new motor vehicle sales



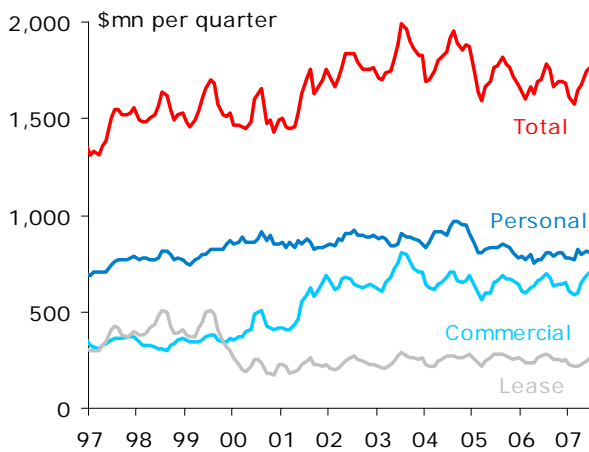
Sources: ABS 9314.0; Economics@ANZ

**New vehicle sales by buyer type**



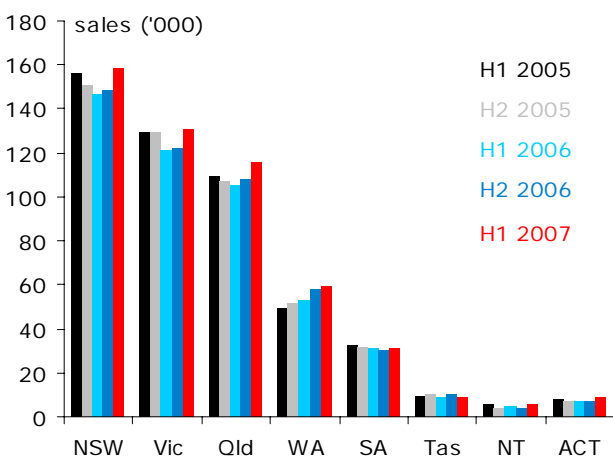
Source: FCAI

**New finance commitments for vehicles\***



\* Value of new finance for all motor vehicles, including new and used cars, motorcycles and commercial vehicles. Source: ABS 5671.0

**New vehicle sales by state**



Source: ABS 9314.0

**Who is buying?**

Purchasers of new vehicles may be identified as private individuals, businesses, government and rental fleets. In financial year 2006-07, private buyers bought 47.7% of all new vehicles (including 55.6% of passenger cars and 53.1% of SUVs), businesses bought 35.8%, governments bought 7.9% and rental fleets bought 5.4%. Heavy commercial vehicles (large trucks and buses) are counted separately, and account for around 3.3% of the total market.

**Types of vehicle buyers**

Private buyers have been the most enthusiastic group of purchasers of motor vehicles in the first half of 2007, with sales almost 10% higher than for the same period a year ago. Household incomes have been well supported by strong employment growth and solid wages outcomes over this period, with strong asset price growth (both in housing and equities) further adding to spending confidence. A mild easing in petrol prices in 2007 has also aided growth in new car sales. These factors appear to have far outweighed the impact of the three interest rate hikes in 2006.

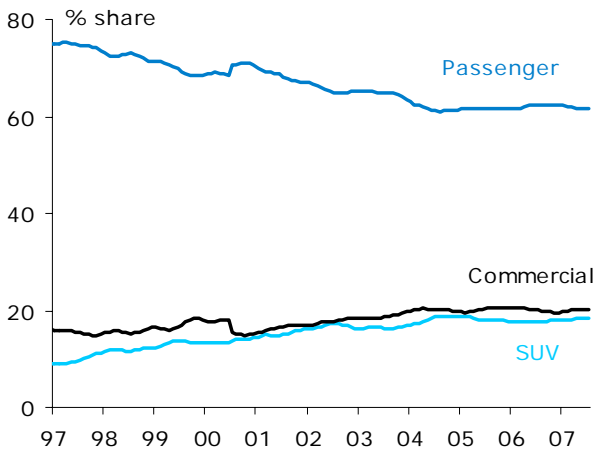
Business buyers have been encouraged by the stability in interest rates between November 2006 and August 2007 and the general ongoing strength of business investment. Early seasonal rains may have also encouraged increased rural purchases. Sales to rental and heavy commercial vehicle buyers have also improved this year, with government purchase remaining flat.

**Location of vehicle buyers**

Sales of motor vehicles in the first half of 2007 improved most strongly in the eastern seaboard states following a number of periods of soft (and even declining) sales growth. In seasonally adjusted terms, sales boomed by 7.1% in both NSW and Queensland in the first half of 2007 (compared with sales in the second half of 2006), and by 6.9% in Victoria. Sales in the ACT, the second smallest market for motor vehicles, soared by a staggering 13% in the same time period. The rapid growth in the Western Australian car market eased a little, with sales increasing 3.7% in the first half of 2007 as compared to an 8.2% jump in the second half of 2006. Sales growth in the Northern Territory (+5.3%), South Australia (+4.6%) and Tasmania (+3.2%) also improved on sales performances in the second half of 2006.

In July 2007, this positive sales trend continued in most states, with aggregate sales rising 0.6% in the month. Small falls were recorded in just Victoria (-0.3%) and the Northern Territory (-3%).

Market share by type of vehicle

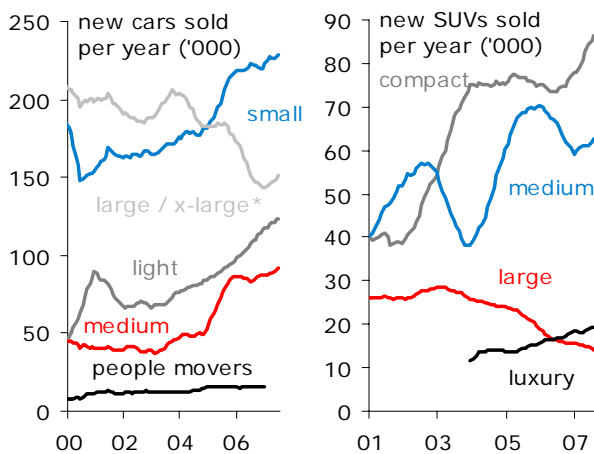


Source: ABS 9314.0

What are we buying?

The domination of passenger cars in the market continued into the first half of 2007, accounting for 62.2% of new vehicle purchases (down from over 75% in the mid 1990s). Market shares for commercial vehicles and SUVs have remained broadly stable, representing 19.9% and 17.9% of the market respectively (although both are up from 16% and 8% ten years ago). Thus far in 2007, private buyers purchased just over half of all passenger vehicles and SUVs, and one fifth of all commercial vehicles (mainly PU/CCs). The remainder are purchased by businesses (over one-third of SUVs and two-thirds of light commercial vehicles), with smaller proportions going to rental fleets and governments.

Passenger car and SUV sales

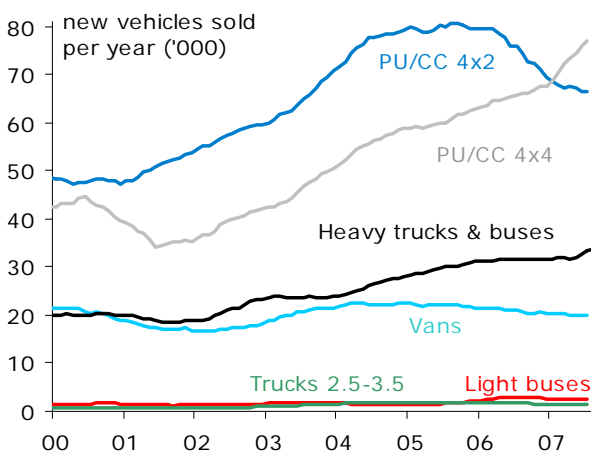


\* x-large cars from Dec 2004. Luxury SUVs from Jan 2003. Source: FCAI

Passenger cars and SUVs

Purchaser preference for smaller models of passenger vehicles and SUVs has become well entrenched in the Australian marketplace. However, following a number of years of steady decline, the first half of 2007 witnessed a small turnaround in the sales of large and extra-large cars, rising by around 7% in annual terms. This may be partially explained by a mild easing in petrol prices, as well as the trend for many large and luxury vehicles to be bought as business vehicles (with fuel being paid for with fuel cards or pre-tax dollars, thereby making the purchase a less emotive decision). Nonetheless, light and small cars continue to account for 60% of passenger car sales and over one-third of total vehicle sales.

Commercial vehicle sales



Source: FCAI

In the SUV market, sales of medium-sized models began to recover from a steady decline which started in early 2005, up 8% in the first half of 2007 in annual terms. Luxury model sales continued to perform well in the first half of 2007, while the sustained decline in large SUV sales eased to -13.5% in annual terms (from an annual decline of around 25% for the same period last year).

In both passenger and SUV sales, non-petrol fuel types (diesel, LPG and hybrid) persist in making inroads, influenced by sustained high petrol prices and increasing environmental awareness. Although still tiny, non-petrol sales accounted for 6% of all passenger car sales in the first half of 2007 (up from 4% in the same period last year) and 24% of all SUV sales (up from 20% a year ago).

Commercial vehicles

The decline in total sales of new commercial vehicles over 2006 has been largely arrested in the first half of 2007, with sales up by an average of 6% in annual terms. However, this recovery is not broad based among the sub segments of the market - sales of vans and PU/CC 4x2 remain weak, while sales of PU/CC 4x4, and to a lesser extent, heavy trucks and buses, are the primary drivers of commercial vehicle sales growth.

## Australia's favourite marques

Top 5, % of all sales*	2000	2006	2007 YTD
1. Toyota	19.9	22.2	22.2
2. Holden	19.0	15.2	14.5
3. Ford	14.5	11.9	10.4
4. Mazda	3.5	6.6	7.5
5. Mitsubishi	9.3	5.6	6.4
<b>Total sales</b>	<b>787,100</b>	<b>962,666</b>	<b>610,667</b>

\*Sales of all new imported and Australian-made vehicles.  
Source: FCAI

## Australian auto production &amp; sales

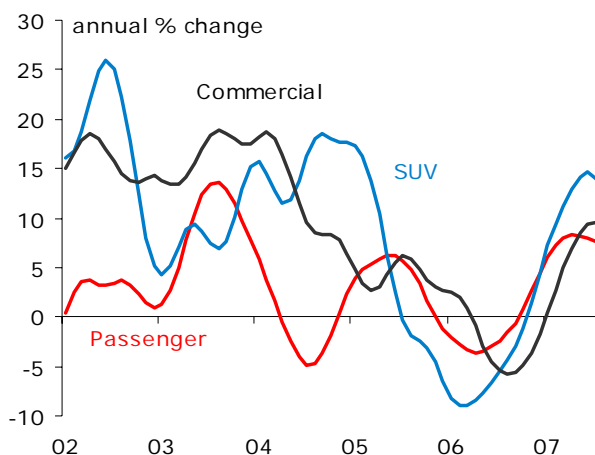
	Total Aust. production	Aust. sales & market share <sup>#</sup>
1980	364,033	365,334 (66%)
1990	381,780	361,494 (61%)
2000	345,207	247,187 (32%)
2005	388,985	248,912 (25%)
2006	326,960	201,623 (21%)
<i>FAPM forecasts*</i>		
2007	341,557	199,947 (23%)
2008	359,381	204,381 (22%)
2009	373,267	213,267 (22%)
2010	367,469	232,469 (24%)
2011	366,024	230,024 (24%)

Note that these data exclude production of heavy trucks.  
<sup>#</sup> 'Market' is the segments of the Australian market that locally produced vehicles compete in, i.e. it is not the total Australian motor vehicle market.

\* Forecast by FAPM, February 2007.

Sources: FCAI; FAPM, OICA.

## Sales growth (monthly trend)



Source: ABS 9314.0

## The Australian auto industry

There has been no change in the ranking of Australia's favourite marques (by sales numbers) thus far in 2007. Toyota continues to dominate the market, accounting for nearly one in every four passenger and light commercial vehicles sold, whilst the market shares of Holden and Ford continue to slip. On the other hand, Mitsubishi's attempts to broaden its appeal appear to be paying dividends, with the company's share of the local market up 0.8pts in 2007 year to date.

## Australian production trends

Local automotive manufacturers face an increasingly competitive environment, with changes in consumer preferences creating significant challenges. Although it has been apparent for some years now that Australia's love affair with large sedans is waning, Australian manufacturers have found it difficult to switch from high volume production of large vehicles. Ford is the first cab off the rank in responding to the market's increasing demand for smaller, more fuel efficient vehicles, with plans to have production of the Focus up and running by 2011. Annual production will include around 15,000 vehicles for export to countries including South Africa and New Zealand.

The largest export market for Australian motor vehicle manufacturers is the Middle East, with exports to Gulf Co-operation Council (GCC) states valued at \$2.2bn in 2006. Toyota is the primary contributor to this market, exporting \$1.5bn worth of Camrys (around 70% of total production from the Altona plant), to GCC states. Holden exported 31,000 vehicles to the Middle East in 2006.<sup>1</sup> However, a concern for 2007 is that the strong A\$ may have been dulling the competitive edge of Australian exports.

To achieve economies of scale, modern motor vehicles are increasingly being built on common global platforms. Toyota in particular has taken advantage of this production approach, with its Aurion, Corolla and Camry models based on a global platform. This strategy has also allowed Holden to export the popular Commodore model to the US, rebadged as the GM Pontiac G8, and as left-hand drive Chevrolets in the Middle East.

However, there is a twist in the globalisation story. The fate of local automotive component manufacturers is closely intertwined with that of vehicle manufacturers. Local component suppliers are under increasing pressure to scale up production while reducing prices and investing heavily in research and development. Not all have met these challenges. A further complication is that local manufacturers are increasingly looking to offshore suppliers. A recent example is Ford's decision to cease manufacture of the locally made straight six

<sup>1</sup> Tracey Sutherland, 'Car makers need accord with Gulf,' *The Australian Financial Review*, 2 July 2007, p. 7.

## Selected new car releases in Australia

Estimated date	Model
September 2007	Holden VE ute; Jeep Patriot (SUV) Mitsubishi Lancer; Nissan Micra Suzuki SX4
October 2007	Audi A5; BMW M3; Ford Mondeo Holden Hummer (SUV) Kia Carens (MPV); Subaru Impreza Mazda MPV, Mazda2, Mazda3 Toyota LandCruiser, Hilux TRD ute
December 2007	Nissan Qashqai (SUV) Nissan X-Trail, GTR
February 2008	Honda Accord
March 2008	Chrysler Voyager (MPV); Fiat 500 <b>Ford Falcon</b> ; Holden VE wagon Mazda CX-9 (SUV), Mazda6
April 2008	Honda Jazz; Mazda Tribute (SUV)
May 2008	Audi A4
June 2008	Ford Escape (SUV)
October 2008	Holden T2X (SUV) Subaru Forester; Nissan Skyline
November 2008	Saab 9-5
March 2009	BMW 7 Series; Toyota Prius

Source: GoAuto New Car Diary.

Falcon engine and replace it from 2010 with a V6 imported from the USA. This will cost 600 jobs in Geelong although this should be compensated by additional employment associated with production of the Focus.<sup>2</sup>

## Global production trends

Dynamism in the global automotive production environment extends across commercial, environmental and political concerns.

At the business end, diversity persists in manufacturers' fortunes. At one end of the scale, Toyota has overtaken GM in global vehicle sales, and is snapping at the heels of Ford to become number two in the US. Meanwhile, other majors are consolidating their businesses, with Germany's DaimlerChrysler having sold the Chrysler division to a private equity firm, and Ford looking to offload its Volvo division that it purchased in 1999.

Unlike their Japanese and German counterparts, US car manufacturers are finding it difficult to expand into new markets. Korea is a prime example – there has been an increasing appetite for foreign cars among wealthy young Koreans, but German and Japanese companies have been far more successful in selling their premium vehicles.

In the US in particular, the increasingly competitive global environment is also driving a number of diversified manufacturers to sell off their auto-related businesses, preferring to beef up other parts of their portfolios. The components sector is consolidating, allowing for greater clout and economies of scale in order for those remaining businesses to better negotiate with big car makers (which are known for squeezing suppliers for constant cost reductions).<sup>3</sup>

Turning to environmental (and political) concerns in the industry, there has been a global push to make new cars more environmentally friendly. Particularly in the US and Brazil, government regulation has been used as a tool to encourage a reduction in motor vehicle emissions of greenhouse gasses, making it necessary for vehicles to be able to (partially) run on biofuels such as ethanol and biodiesel. However, on closer inspection it is apparent that this push may be more politically motivated than a true tool to make vehicles more environmentally friendly. Some evidence suggests that biofuels such as corn-derived ethanol may be no greener than regular petroleum-based automotive fuels given the huge amounts of energy required to grow the crops and subsequently process them into biofuel. Growing corn also tends to deplete the soil and relies heavily on fertiliser, whilst taking more water to grow than many other crops. Moreover, whilst Brazilian ethanol derived from sugarcane has

<sup>2</sup> Duncan Hughes, 'Car chief: adapt or hit the road,' *The Australian Financial Review*, 26 July 2007.

<sup>3</sup> Timothy Aepfel, 'Parting ways: more parts producers give up on automotive industry,' *Chicago Sun-Times*, 3 August 2007.

**Expected total new vehicle sales**

Annual sales	Number	Annual growth %
2005	988,269	3.5
2006	962,666	-2.6
2007e	1,030,000 – 1,035,000	7.0 – 7.5
2008f	1,025,000 – 1,035,000	-0.5 – 0.0

Source: ABS; Economics@ANZ.

**Key Australian economic forecasts**

Annual growth %	2007(f)	2008(f)
Gross domestic product (GDP)	4.2	4.1
- non-farm GDP	4.6	3.8
- farm GDP	-11.0	17.8
Private consumption	4.0	3.7
Total business investment	12.9	4.8
- equipment investment	9.0	2.3
Employment	2.9	2.8
Unemployment rate (%)	4.4	4.2
Wages (WPI)	4.1	4.2
Consumer Price Index (CPI)	2.3	3.1

Source: Economics@ANZ (as at 5 September 2007).

been proved to be more energy efficient in terms of production, the US government continues to protect domestic producers with a 2.5% duty plus a 54-cent tariff on imported ethanol.<sup>4</sup> However, a less controversial 'green' move has been made by Ford which is beginning to use a soy-based foam in the seats of US-produced cars instead of the usual petroleum-based polypol foam.

**Sales outlook**

Total motor vehicle sales have achieved a good recovery in 2007 thus far following a 2.6% fall in 2006. Sales topped the 'magic million' in financial year 2006-07, the first time ever in any twelve month period. Annual trend growth in SUVs has bounced back, with growth in the passenger and commercial segments also solid. Given the year's bumper start, the outlook for total sales in 2007 is very healthy, with sales of around 1.03mn vehicles likely.

**Passenger cars and SUVs**

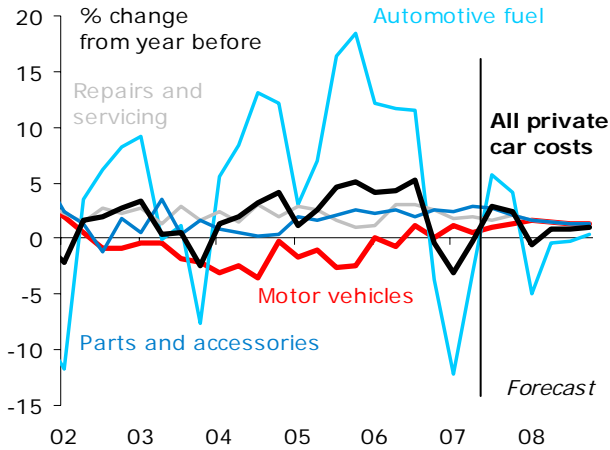
Strong growth in household incomes on the back of solid gains in employment, wages and wealth will continue to be the key drivers of passenger car and SUV sales growth over the remainder of 2007 and into 2008. We forecast continuing robust economic growth to keep the national unemployment rate at multi-decade lows, averaging 4.4% in 2007 and dipping down to 4.2% in 2008. The non-farm sector will remain robust over the forecast horizon, augmented by higher rural incomes on the back of increased production and high prices for rural products. Demand across the states is expected to be more even, with the mining-heavy states cooling from their recent rapid pace of growth and the south eastern states and territories lifting their performance.

No further changes in monetary policy are expected in the near term, with recent global financial market volatility clouding policy options. Nonetheless, with strong growth and price pressures persisting in the domestic economy, it is likely that the interest rate cycle is not over, and we have pencilled in a 25bps hike in February 2008. The good news for consumers is that household income growth is expected to remain solid over the forecast period, and petrol prices should stabilise below recent highs. Although households have appeared for some time now to have adjusted their spending to higher petrol prices, they do remain a key influence for many purchasers' choice of vehicle type (and fuel type).

No significant new passenger car models are due for

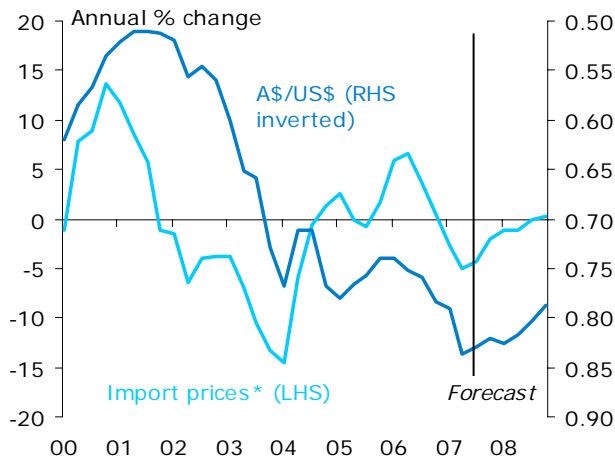
<sup>4</sup> The US Department of Agriculture estimates that for each unit of energy put into producing ethanol from corn, approximately 1.34 units of energy are produced (using sugarcane, Brazil gets around eight units of energy from each unit of energy used). Source: Glen Anderson, 'Homegrown energy: as America crops with climate change, many see hope in biofuel,' *State Legislatures*, Volume 33, Issue 6, 1 June 2007, p. 16.

**Private motor vehicle operating prices**



Source: ABS 6401.0; Economics@ANZ

**Exchange rate and import prices**



\*composition-adjusted import price deflator.  
Source: ABS 5206.0; Bloomberg; Economics@ANZ.

release in the remainder of 2007 that might prompt a sales spike, with the next big release for the local market being Ford's new Falcon in 2008.

**Business / commercial vehicles**

Although it started the year strongly, business investment in plant and equipment (including vehicles) is expected to slow over the balance of 2007 and into 2008. As a result, commercial vehicle sales growth, which kicked off the year in spectacular fashion, is likely to ease over late 2007 and 2008. Recent financial market uneasiness and an increase in the cost of business credit may also have a negative impact if sustained for a sufficient period of time.

The state of the farm sector is expected to improve somewhat over the forecast period, although it is still too soon to say that the drought has broken and harvests are likely to still be down on peak seasons. However, some recovery in the sector should support some upgrading of vehicles and restocking. Likewise, housing construction is forecast to pick up in 2008 due to the growing shortage of housing stock combined with strong underlying demand, and will be another positive contribution to growth in commercial vehicle sales.

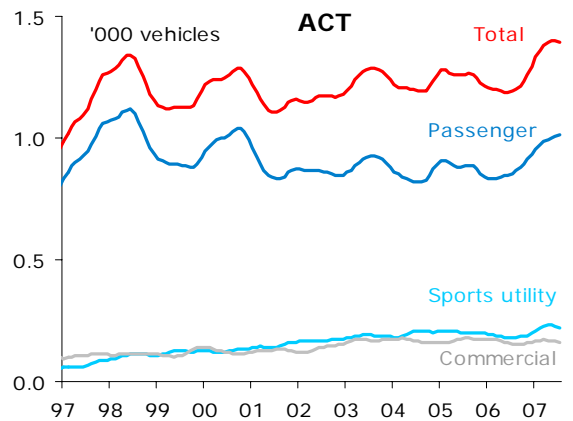
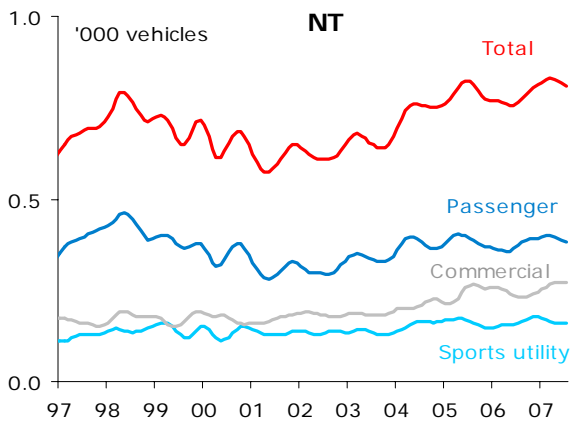
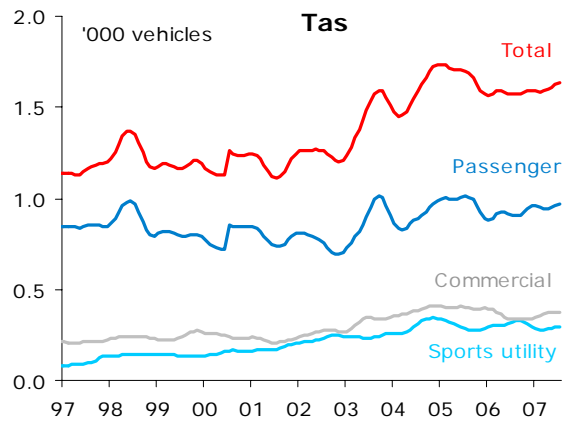
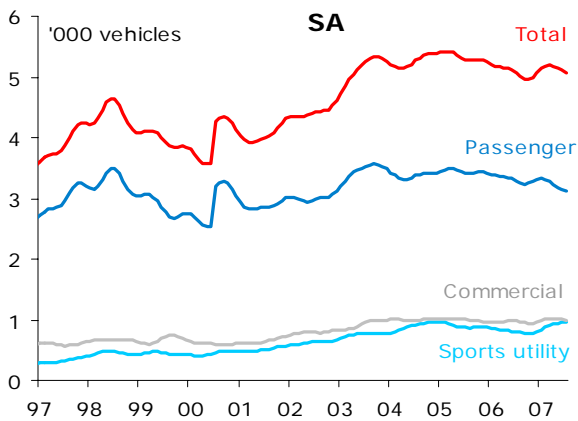
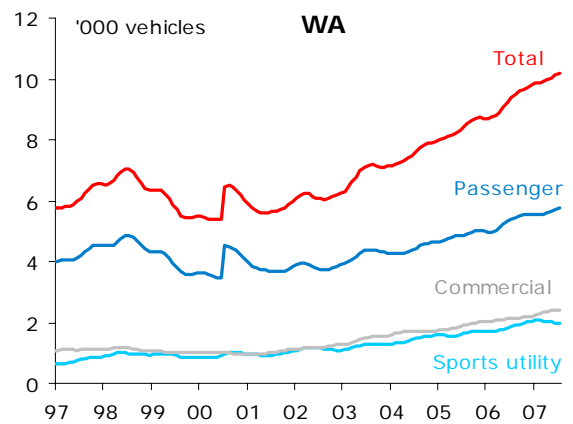
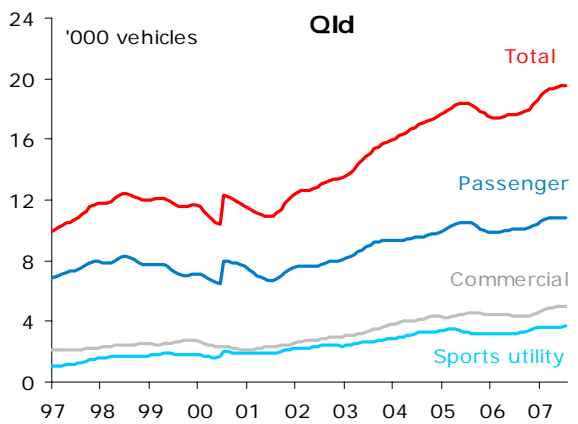
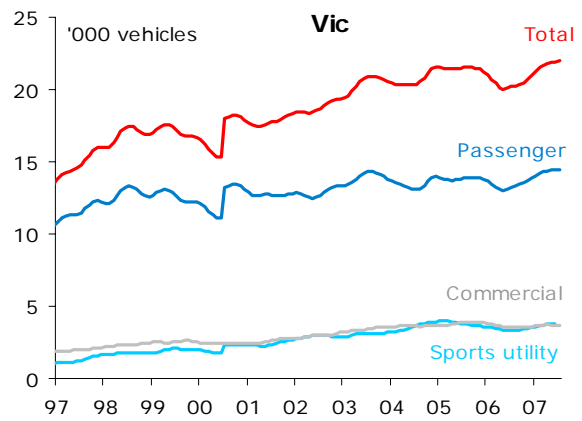
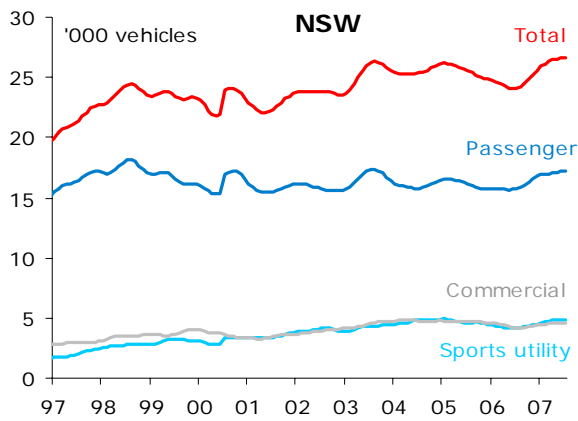
**Prices outlook**

The downward slide of new motor vehicle prices over much of the late 1990s and 2000s (due to import tariff and tax changes; favourable exchange rates; and an ultra-competitive international automotive industry) has recently come to a halt. Since mid 2006, the motor vehicle component of the CPI has indicated that average new car prices have been increasing at an annual rate of around 1%.

Going forward, a number of key factors will continue to significantly influence average new vehicle prices. Since around 80% of all new vehicles purchased are imported, Australia's exchange rate will continue to be a primary driver of new car prices. In recent times, high commodity prices, interest rate differentials and a strong global economic environment have supported the A\$. However, for the remainder of 2007 and 2008, with prices for several of Australia's key commodities appearing to have peaked, combined with recent financial market volatility and a 'flight to quality' out of A\$ denominated assets, the A\$ is forecast to gradually weaken relative to its current strong level. This is likely to add to the local prices of imported products.

Having said that, given the highly competitive nature of the global automotive industry, some models may continue to fall in price. Also, some commentators have suggested that Australian used car prices could continue to fall, potentially having an impact on the new car market. However, on balance, we believe that the weakening A\$ will support new motor vehicle prices over the forecast period.

## Appendix: new motor vehicle sales per month, by state (trend)



Source: ABS 9314.0



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