ANZ Economics & Markets Research

Motor Vehicle Outlook

Automotive sales shift down to low gear

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Inside:

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Our Vision:

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

This series of reports analyses emerging trends in the Australian market for new motor vehicles. The last report was released in February 2008.

Key points

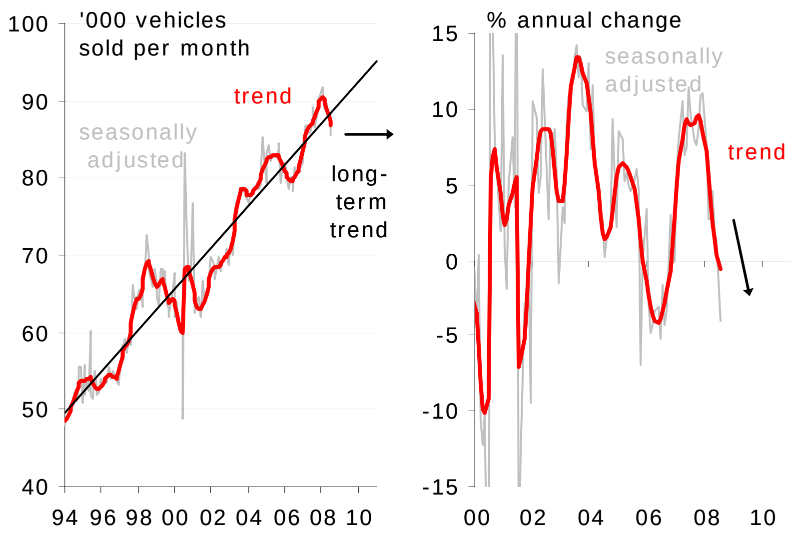
- 2008 auto sales growth is decelerating towards a likely annual growth rate of just 1 to 2% for the year (around 1,065,000 new vehicles).
- 2009 sales growth is likely to be flat at best, due to a more subdued economic outlook for Australian households and the wider economy.
- The local automotive industry faces a tough local and international environment, but looks set to gain even more government assistance.

Broad sales trends

2008 has seen a steady deterioration in automotive sales growth rates. Seasonally adjusted sales growth (monthly sales, year on year) has been steadily decelerating since Dec 2007, while trend sales growth has been decelerating since Oct 2007. In July 2008, sales growth turned negative on both measures. For the year to July, total sales were just 2.6% higher than a year earlier and appeared to be tracking in line with our February forecast of sales growth of 1-2% for the 2008 calendar year. But with the Australian economic slowdown now weighing heavily on households, there is a risk that even this cautious forecast could be too optimistic. 2008 sales might finish equal to or below 2007's record of one million car sales.

2009 sales look set to stay at or below their long-term trend level of just over one million vehicles, in response to flat demand. 2009 will see credit costs come down again, but inflation, cost pressures and financial market uncertainties will remain an issue, as will the weak international economic outlook. Passenger car import tariff cuts scheduled for 1 January 2010 (from 10% to 5%) are also likely to affect 2009 car sales, as prospective buyers wait for the tariff reduction to flow through to retail prices in 2010.

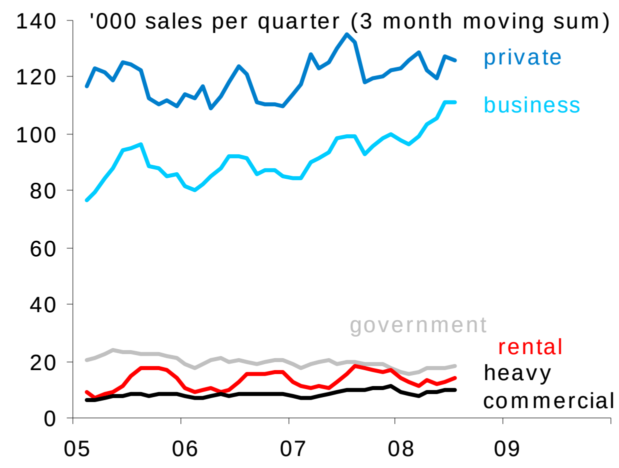
Sales have fallen below the long-term trend. Growth is negative



Sources: ABS, ANZ Economics and Markets Research.

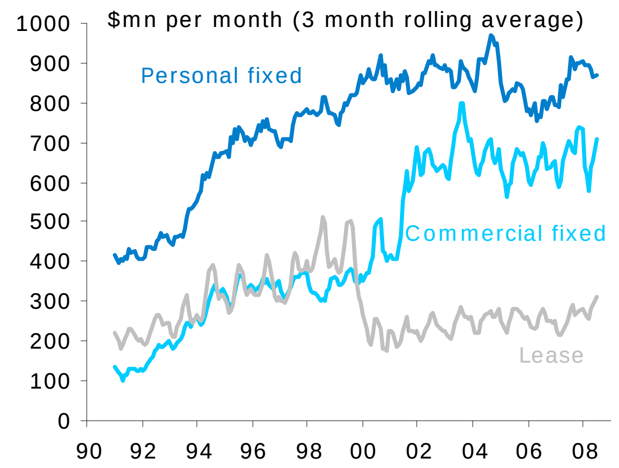
Who is buying new vehicles?

Private buyers stall, but business sales strengthen



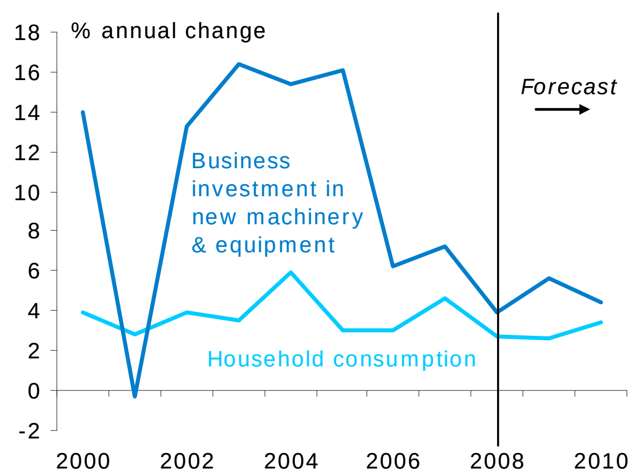
Source: FCAI

Auto finance commitments fell 11.5%, H1 2008*



* Nominal value of finance commitments for all new and used cars, motorcycles and commercial vehicles.
Source: ABS 5671.0, *Lending Finance*

Auto sales reflect national trends in household and business spending growth



Source: ABS and ANZ Economics and Markets Research.

More new vehicles have been sold in 2008 to date than at the same time in 2007. Monthly sales are, however, declining rapidly. January was 7.6% higher than the record set a year earlier (seasonally adjusted), but by July, both the seasonally adjusted and trend growth measures had turned negative. In year to date terms, **total auto sales** have gone from 7.2% growth in February, to just 2.6% in July. We expect sales growth to slow further in H2 2008.

So far, the sales slowdown has been most evident among **private** buyers. Although household discretionary income and employment growth have remained solid through 2008, rising fuel prices, interest rates and other prices, together with a corresponding decline in consumer sentiment, have knocked the wind out of household consumption growth. This change in mood has affected car sales as it has other spending. In the Westpac consumer sentiment survey for example, the index of consumers who agree that "now is a good time to buy a car" plummeted by 31% between June 2007 and June 2008 and is now at its lowest level since June 2000, just before the GST was introduced.

A complicating factor for private car sales has been the increase in the luxury car tax, announced in the May Federal Budget and applied from 1 July 2008 (see below). This caused many affected car buyers to try to move their purchases forward to June.

Business vehicle purchases are following a different trend. Monthly sales to businesses of cars, SUVs and light commercial vehicles hit an all-time record of 41,500 in the annual peak month of June, plus another 3,500 heavy commercial vehicles. Even the normally slow sales month of July was up 14% on a year earlier among business buyers. This was despite a flat year for residential construction and rising cost pressures in the transport industry.

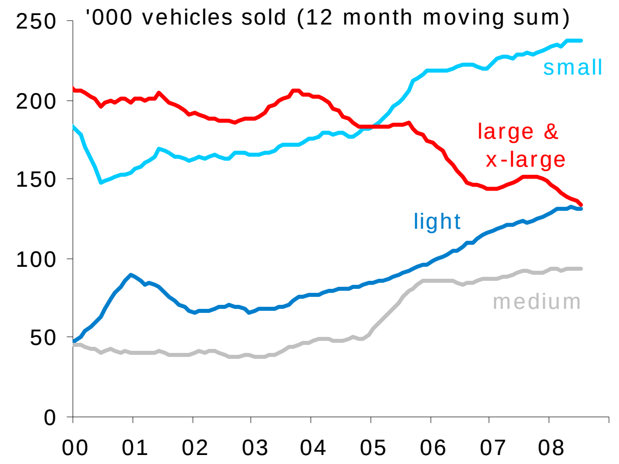
Monthly **auto finance** data tell a similar story. Total automotive finance commitments for the first half of 2008 were down 11.5% (by nominal value) from the same period in 2007. Personal commitments were down 11.9%, fixed commercial finance was down 15.3% and lease finance was down 0.2%. Among business (commercial) buyers, there may have been some substitution out of fixed finance into leases, possibly in response to rising credit costs.

These sales trends reflect national spending trends among households and businesses more broadly. The rate of growth in business investment in new machinery and equipment (including vehicles) has slowed from the double digits in 2003 to 2005, but remains relatively healthy at around 4% p.a. estimated for 2008. Household consumption growth is weaker, at only 2.7% p.a. estimated for 2008.

Looking at automotive sales across the States and Territories, the downturn in sales in 2008 began earlier and was most apparent in NSW, Qld and WA. Victorian and SA sales have held up better, but are now starting to turn down also (see appendix).

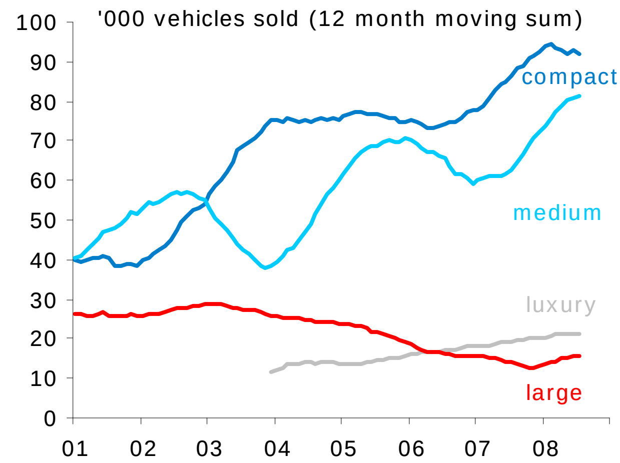
Which new vehicles?

Large passenger cars continue their decline



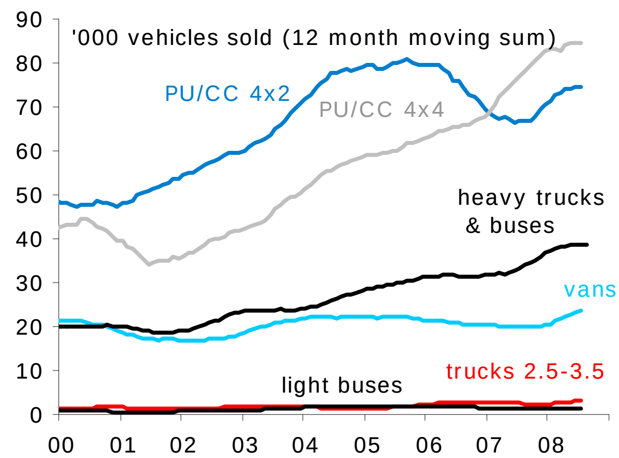
Source: FCAI

The SUV market has stalled



Source: FCAI

Trucks and 4x4 commercial sales surge ahead



Source: FCAI

Passenger cars

High fuel prices are still showing their influence on Australian passenger car purchasing preferences. Large car sales have declined every month now for nearly a year (in annual growth terms) and have been in long-term decline for at least five years.

Small cars and lately, light cars, have more than made up the gap in sales numbers. In the year to the end of July 2008, the small and light car categories had each both out-sold 'large' and 'extra large' cars combined. The even larger 'people mover' category was down from 2007 sales, while sports cars were down slightly from 2007's record.

In its May 2008 Budget, the Government announced an increase in the existing Luxury Car Tax from 25% to 33%, commencing from 1 July 2008. This tax applies to the portion of each passenger car price that is over $57,123. The increase will inflate the cost of an $80,000 car for example, by $1,830. The announcement had the immediate effect of bringing forward a significant number of car purchases, so as to avoid the tax increase. This caused a sale 'bubble' in June and a subsequent slump in July. This slump is expected to continue for some months. Going forward, the future of this tax increase is uncertain, since it has not actually been passed by the Senate yet, but has instead been referred to a Senate inquiry. In the event that it is not passed, refunds will be issued to all affected 'luxury' car buyers.

SUVs

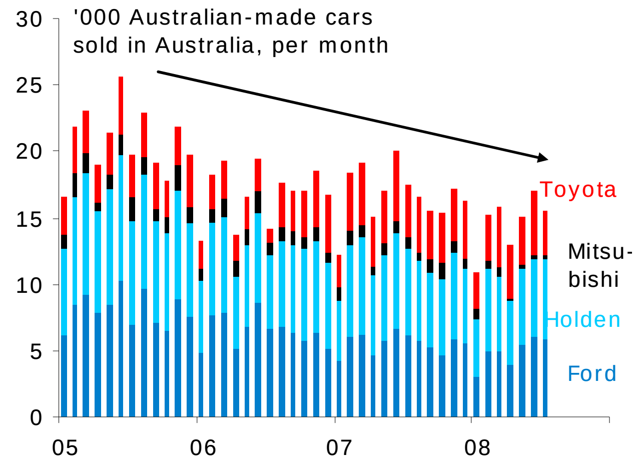
With prices expected to remain elevated for both petrol and diesel, Australians' love-affair with large SUVs might finally be over. In July, SUV annual sales growth turned negative in both seasonally adjusted and trend terms for the first time since 2006. Within the SUV market, the medium category continues to show growth, but compact, large and luxury SUV categories have all stalled.

Commercial vehicles

Despite gloomy consumer and business sentiment and elevated credit costs, the commercial vehicle market is continuing to expand, albeit at decelerating rates. Annual sales growth has remained positive right through to July 2008 (seasonally adjusted and trend), but is expected to slow further and even hit negative growth later in the year. Most categories of light commercial vehicles are continuing to show good growth potential, in annual growth and year to date terms. 4x4 utes continue to be favoured over 4x2 models.

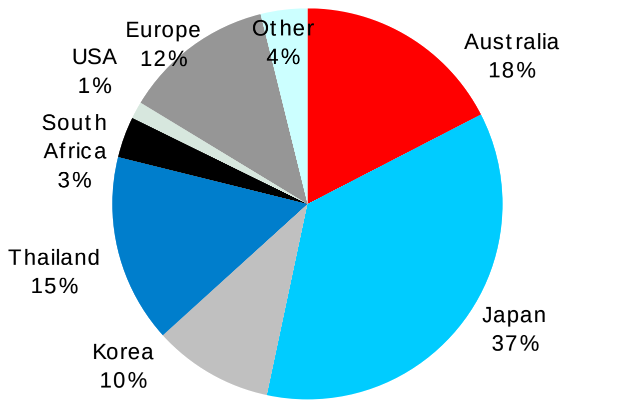
The heavy truck market boomed through 2007 and may now have peaked, as the transport industry faces big fuel cost increases and a profit squeeze.

Local sales of Australian-made cars keep sliding



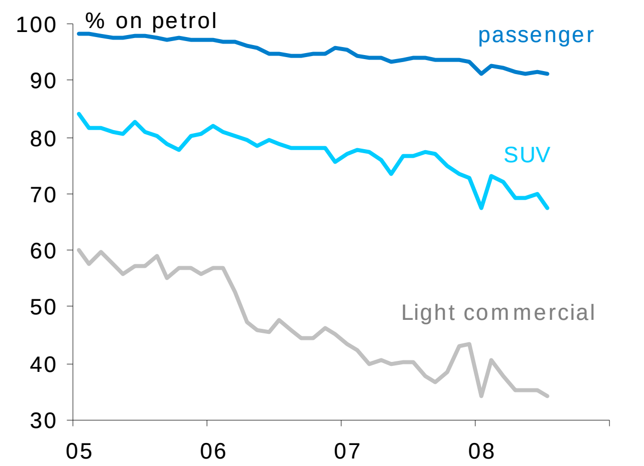
Source: FCAI

Japan remains our favourite car maker. Thailand is quickly gaining market share (2007-08 sales)



Source: FCAI

The dominance of petrol is very slowly declining



Source: FCAI

Source countries for vehicles

The market share of Australian-made vehicles slid to 18% in 2007-08. This is part of a long-term pattern, caused by a variety of factors including: import tariff reductions; strong international competition; changing buyer preferences; and, not least, a narrow product range on offer from local producers.

Toyota, Holden and Ford remain Australia's top 3 selling marques. But even for them, locally produced vehicles make up only a portion of their total sales: 20%, 51% and 62% respectively in 2007.

Reflecting Toyota's market dominance (approaching a quarter of all new vehicle sales), about half our new vehicles came from Japan or Korea in 2007-08. Another 12% came from Europe. These shares haven't changed much in the last three years. Thailand has trebled its market share in a very short time, from 5% in 2005 to 15% today. Thai car production facilities have expanded rapidly and our Free Trade Agreement gives them preferential entry. Critics argue Thailand's auto industry is overly supported by Government assistance — a common criticism in the auto industry as in many others.

The popularity of imported vehicles reflects their low price, but also the wide variety of models available, with a range that cannot be easily matched locally. The price of imported passenger cars will fall again in 2010 when the import tariff falls further, from 10% to 5%, shaving $2,500 from a $50,000 car.

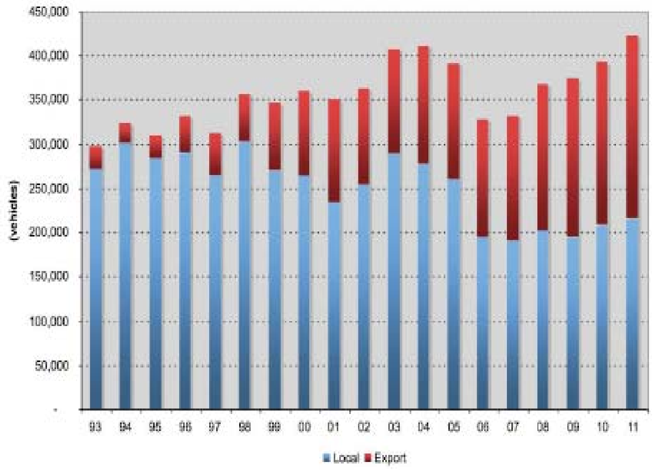
Fuel types: are we getting greener yet?

Our cars may be getting smaller (or, in the case of trucks, bigger), but are they getting any greener? The proportion of new vehicles that do not run on petrol is slowly creeping up, but the main replacement fuel is diesel, not LPG or hybrid systems. From January 2005 to January 2008, the proportion of new passenger cars running on diesel increased from 0.7% to 6.5%. Hybrids grew from 0.3% to 0.7% (from 128 to 385 cars per month) and LPG grew from 0.7% to 1.6% of car sales. Diesel SUVs more than doubled, from 15% of SUVs in 2005 to 32% in 2008. Diesel grew from 40% to 62% of light commercial vehicles over these years.

The Bracks Review (see below) recommends increasing Government subsidies of LPG conversion at the time of manufacture (as opposed to post-sale retro-fitting) from $1,000 to $2,000 per vehicle. Most LPG systems are still installed post-sale.

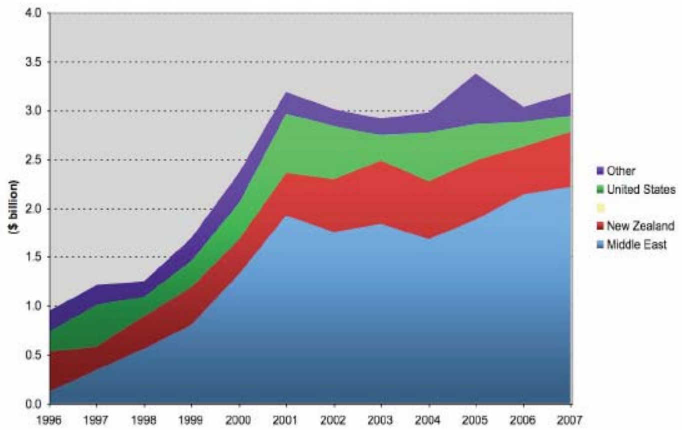
With regard to fuel efficiency, new vehicles are, on average, more fuel-efficient than older ones. And the average small car consumes less fuel per kilometre than a larger one. So despite more SUVs on our roads in recent years, our national auto fleet is becoming more fuel efficient on average and in aggregate. For more information on vehicle fuel efficiency and consumption trends, see our recent reports on fuel costs for Australian industries and households (available on our website).

FAPM expects Australian automotive production and export demand to grow again from 2008…



Source: FAPM submission to the Bracks Review 2008.

.. but auto export earnings have been flat since 2001.



Source: FAPM submission to the Bracks Review 2008.

Bracks' Auto Review 2008. Key recommendations:

- keep the current plan to reduce import tariffs on passenger cars from 10% to 5% on 1 Jan 2010,
- include transport and fuel in emissions trading,
- replace the current Auto Competitiveness and Investment Scheme ($7bn from 2001 to 2015, mainly in import duty credits) with a new Global Auto Transition Scheme from 2010, and pay an extra $1.5bn from 2010 to 2015 plus another $1bn to 2020, to be paid mainly in cash grants,
- extend the current uncapped production credits scheme (per car) from 2015 to 2020 and from domestic sales only to exported vehicles also,
- double the current Green Car Innovation Fund to $1bn and bring spending forward to 2009,
- encourage expanded free trade agreements in the Middle East, ASEAN and South Africa, and
- harmonise and reduce Australian state-based car sales taxes, stamp duty and registration fees.

Source: Bracks Review 2008.

Australia's auto industry

After significant drops in output in 2006 and 2007, FAPM hopes Australian auto production will grow again from 2008, with export demand picking up the gap left by dwindling local sales. Even by FAPM's own estimations however, this seems overly optimistic. Australia's earnings from auto exports have been relatively flat since 2001, with growing sales to the Middle East matched by declining sales to the US. Export growth will become harder to achieve in 2009, as the US, New Zealand and other key auto export markets lurch closer to recession.

As foreshadowed in our last *Motor Vehicle Outlook*, the smallest of Australia's four automotive manufacturers, Mitsubishi, closed its Adelaide plant in March, making redundant its 980 employees, plus up to 280 employees of its components suppliers. This event, and concerns about the future of our remaining three multinational auto manufacturers, prompted another Government industry review this year. It was chaired by former Victorian Premier, Steve Bracks and completed in August 2008.

This latest review comes against a background of several decades of industry reform and assistance, commencing in the 1980s with the 'Button Plan' of import tariff cuts. Import tariffs on passenger cars are now 10% (since 2005), but are scheduled to fall to 5% in 2010. The tariff on commercial vehicles and 4WDs is already 5%. The Bracks Review recommends no change to these tariff schedules.

Government assistance since the 1980s has been significant. In 2002, the Productivity Commission estimated that assistance to 2002 had been worth $1bn per year — or $2,800 per locally produced vehicle — in the form of grants, subsidies, industry support measures and tariff equivalents. Additional assistance came from state governments. In total, the Commission estimated an 'effective rate of assistance' of 20% for the auto industry by 2005, compared with just 4% for all other manufacturing.[1]

The current 'Automotive Competitiveness and Investment Scheme' was worth a total of $7bn from 2001 to 2015.[2] The 2008 Federal Budget added another $500mn for a 'green car innovation fund' and $40mn for 'industry innovation'. The Bracks Review recommends that these funding amounts be increased yet again, and that the timetable for assistance be extended to 2020 (see box, left).

Since the Review's release, Ford Australia has announced more local job cuts and the departure of its CEO of just six months, in response to "an expected fall in sales". Without a major change in direction by the industry itself, it seems unlikely that these latest proposals for more government assistance will stem the decline in local production.

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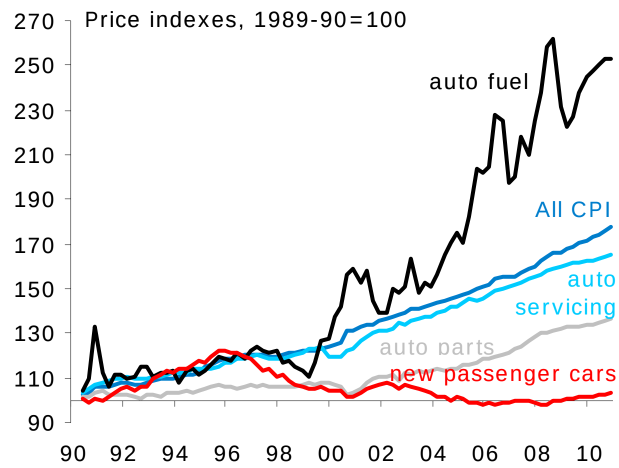
[1] Productivity Commission 2002, *Automotive Assistance*.
[2] Dept of Innovation, Industry , Science and Research.

New car prices are flat, but petrol prices soar



Source: ABS, ANZ Economics and Markets Research

Economic growth and spending are slowing down

Annual growth %	2007	2008f	2009f
Aggregate income			
GDP	4.3	2.5	2.7
Wages (comp. to employees)	8.5	6.6	5.3
Profits (gross op. surplus)	9.4	10.3	8.1
Employment	2.8	2.3	0.9
Unemployment rate (%)	4.4	4.4	5.2
Household disposable income	9.4	6.2	8.6
Aggregate expenditure			
Dwelling investment	3.1	-1.3	1.1
Non-dwelling construction	17.4	5.9	5.0
Business investment in plant and machinery	7.7	4.2	5.9
Government demand	2.7	4.3	2.1
Household consumption	4.6	2.7	2.5
Household savings ratio (%)	1.5	1.6	5.4
Total credit	15.4	10.8	7.0
Prices			
Wages (WPI)	4.1	4.4	4.4
Consumer Price Index (CPI)	2.3	4.4	3.4
A$ / US$ (year end)	0.875	0.920	0.830
RBA cash rate, year end (%)	6.75	6.75	6.25

Sources: ABS, RBA, ANZ (forecasts at 22 August 2008).

Flat auto sales growth expected in 2008 and 2009

Total sales	2007	2008f	2009f
Number	1,049,982	1,060,000 to 1,070,000	1,040,000 to 1,070,000
% change p.a.	9.1	1 to 2	-2 to 0

Sources: FCAI; ABS; ANZ.

Automotive price trends

In 2008, nominal new passenger car prices were at about the same level they had been in 1990 (on a retail price index basis). In June 2008 for example, general inflation (all-CPI) was 4.5% p.a., but the new passenger car price index *fell* by 1.3% from a year earlier. This pricing reflects stiff international automotive competition, reduced import tariffs (in 2005) and a rising Australian dollar over this period.

Petrol and diesel prices on the other hand, have soared, such that cars may be cheaper to buy, but they cost far more to run than in the past. Even so, the proportion of total household consumption being spent on operating our cars has actually come *down* in recent years, from 6.4% five years ago to 5.5% in 2008. This is due to household incomes and other expenditure items (such as health, education and entertainment expenses) rising at a faster rate, as well as to drivers responding to high fuel prices by buying less fuel and presumably driving fewer miles.

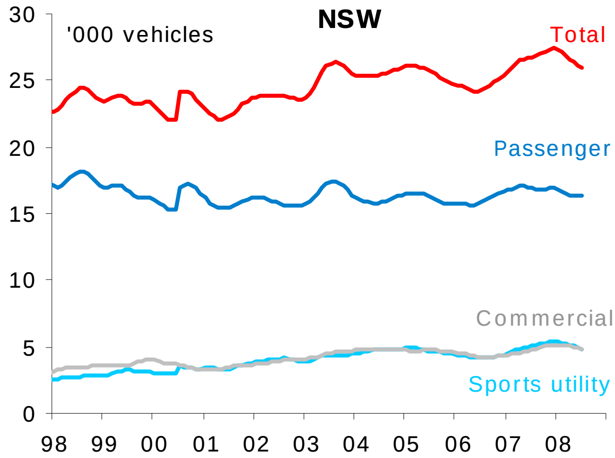
Australian sales outlook

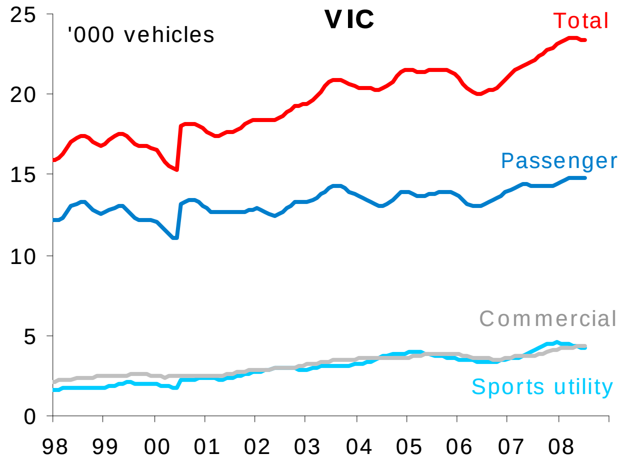
Australia's macroeconomic outlook is deteriorating under the weight of a more difficult international trading environment, volatile financial markets, high credit costs and high fuel costs. But unlike previous slow periods, this one is weighing particularly heavily on Australian households rather than on the corporate sector. In the vehicle market, this trend is manifesting itself in slower sales for passenger cars and from private buyers than for commercial vehicles and from business buyers. The net result is likely to be negligible growth in total car sales for the 2008 calendar year.

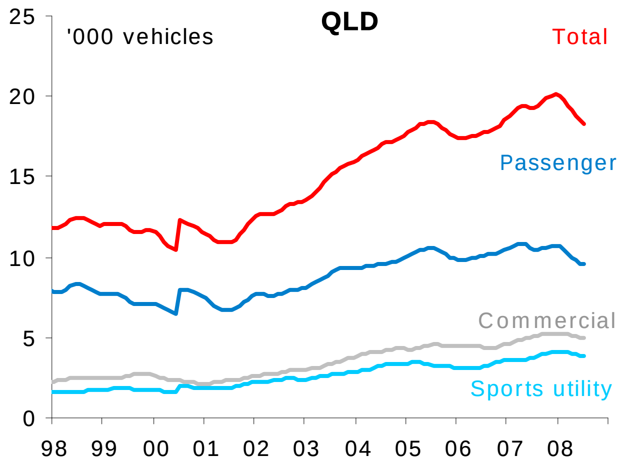
In 2009, we expect the Australian economy to remain relatively subdued. The beginnings of a residential construction pick-up will emerge as credit costs come down again, but this will be offset by a corresponding slowing of growth in the non-dwelling and government construction sectors. High inflation will ease, but so too will wages, profits and employment growth. Growth in aggregate household consumption will slow further, as households consolidate their debts and continuing inflation problems eat into discretionary spending. With petrol and diesel remaining one of the headline pricing problems, new car purchases are likely to be a low priority for many households.

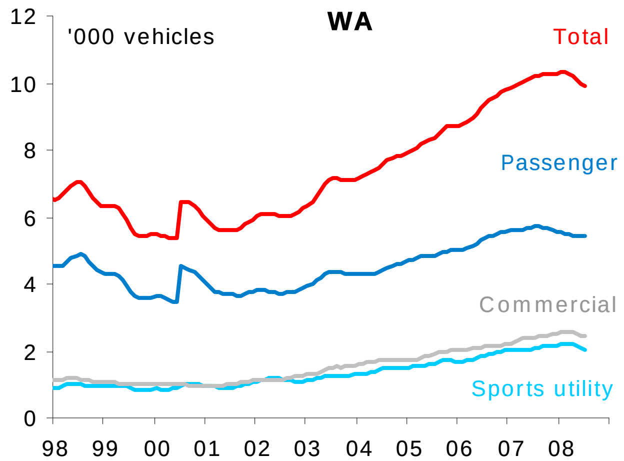
An additional factor that is expected to dampen car sales in 2009 will be the prospect of a further import tariff cut on passenger cars in 2010, from 10% to 5%. This is likely to encourage many prospective car buyers to wait until the tariff cuts have flowed through into retail passenger car prices, providing a boost to sales in 2010. This tariff change should not affect sales of SUVs and commercial vehicles, which already pay a tariff of 5% (no change in 2010). In aggregate, we anticipate total vehicle sales will be flat at best, or possibly fall slightly from 2008 levels.

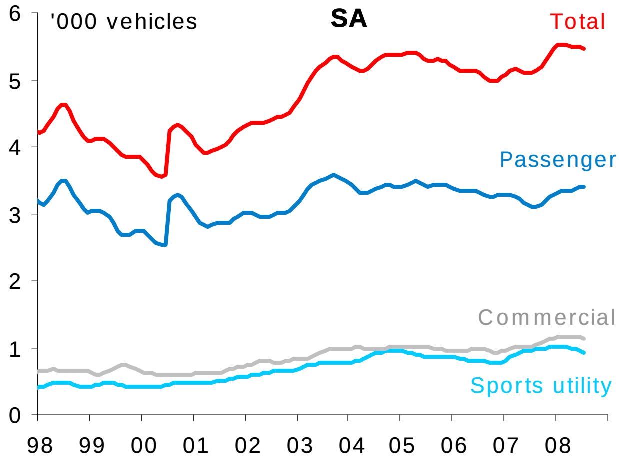
Appendix: new motor vehicle sales per month, by state (trend)

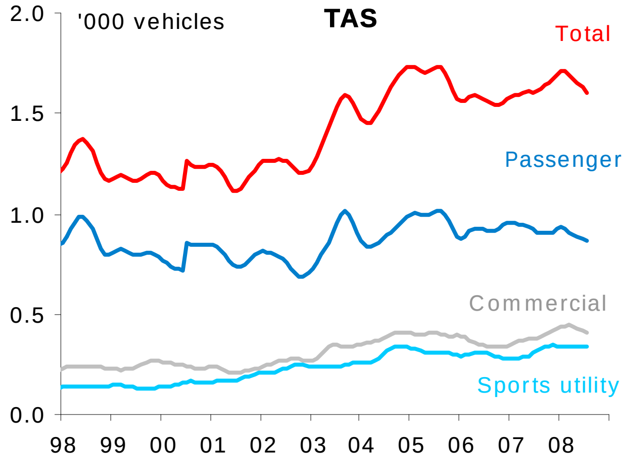


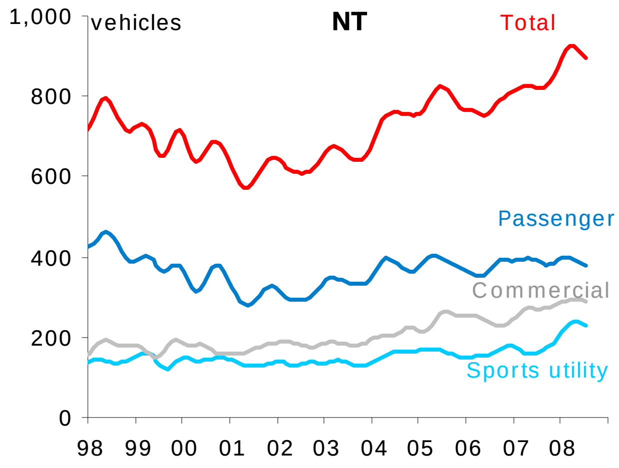


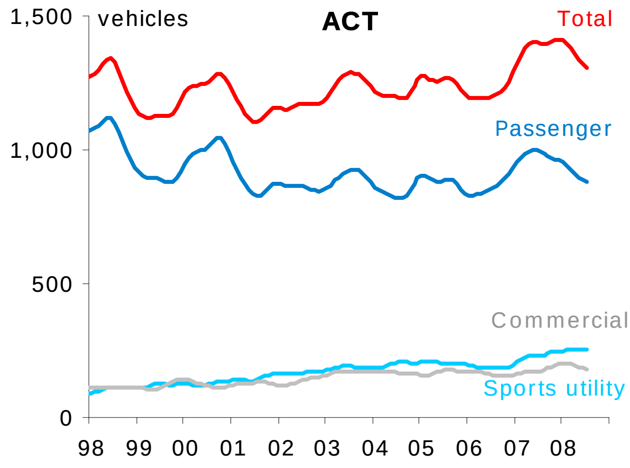




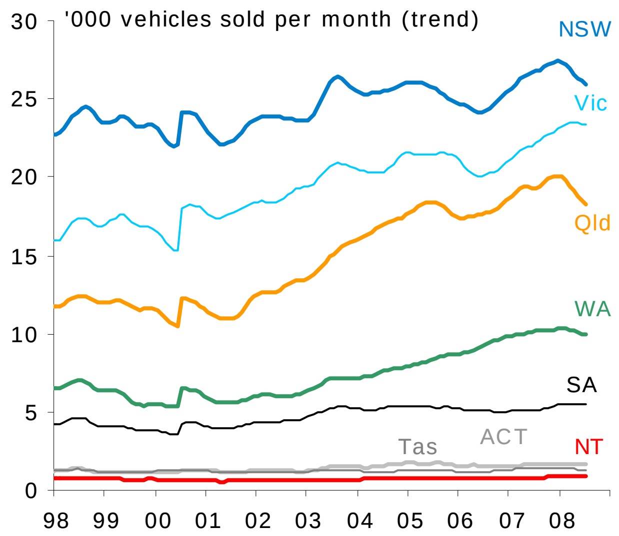




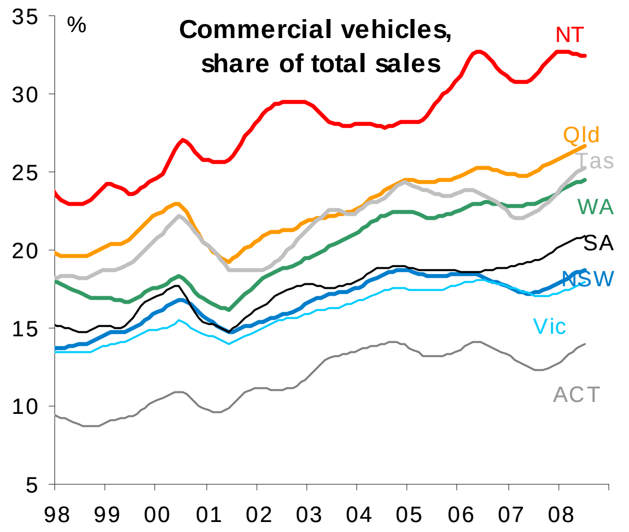




All states and territories, total auto sales



All states and territories, commercial auto sales



Source: ABS 9314.0

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