Is the automobile market set to stall?

Sector analysis by credit insurer Euler Hermes

- **The world automobile market recovered its average annual growth rate of 4% to 5% in 2011 and is expected to remain on a positive trend in 2012, although growth will slow.**
- **Emerging market demand, which drove growth in the automobile sector in 2009-2010, slowed in 2011 and will continue to do so in 2012.**
- **In industrialised countries, the market remains far below its level prior to the 2008-2009 crisis, particularly in Europe where there is still significant overcapacity.**
- **The main challenges facing carmakers are to adapt their offer to emerging markets and to develop industrial partnerships in the areas of innovation and production.**

Paris, December 8, 2011 – The automobile sector suffered its worst crisis ever in 2008-2009, when production plummeted by 15.5% to 61.8 million vehicles. Faced with the freefall of 2009, many countries introduced car scrapping schemes and other car sales incentives, leading to a strong 26% market rebound in 2010. *"The world market returned to cruising speed this year with annual growth of 5% in 2011, i.e. close to 82 million vehicles produced,"* says **Wilfried Verstraete**, Chairman of Euler Hermes' Group Management Board. *"In emerging countries automobile demand appears to be running out of steam which partly explains our forecast of a stabilisation in growth at 5% for 2012."*

Production: growth driven solely by the new markets

Automobile production has increased by 11% **worldwide** over the past five years. However, Europe (-11%), North America (-22%) and Japan (-34%) have stayed well behind over the period. The emerging markets, led by China with growth of 123%, have driven growth for the sector. Thanks to increasing per capita GDP and low car-ownership rates[1] which have boosted demand, the automobile industry grew by 24% in Latin America and, despite the exceptional slump in the Japanese market, by 40% in Asia.

In the face of the drop in production volumes in the more mature automobile markets, some carmakers have managed to adapt. Such is the case in the **United States** where the industry has returned to profitability after large-scale restructuring of its production facilities. Between 2000 and 2009, the workforce at both carmakers and parts manufacturers was halved, in line with production.

The situation in **Europe** is more heterogenous: only Germany has managed to recover to its pre-crisis production levels, while production volumes in Spain, France and Italy are still down by respectively 20%, 36% and 38% compared with their 2007 levels. These three markets have suffered from the fall in demand, but also in the case of France and Italy, from the relocation of a large part of their production to 'low cost' regions.

In **Japan**, which suffered the terrible earthquake and tsunami in 2011, the automobile sector's recovery is even weaker than in Europe. The country's competitiveness has been undermined by the strong appreciation of the yen against the euro.

At the same time, **Korean** carmakers seem impervious to the crisis and continue to gain market share, with 7.5% of world production in 2010 compared with 4.6% in 2005.

New car registrations: after rising on the back of stimulus measures, they may now be set to come to a halt

After two buoyant years, the **Chinese** market is experiencing a lull in 2011-2012 with forecast growth of 'only' 4% to 5%. However, there is no question as to the potential of this market where the car ownership rate (5%) is only one twelfth of the rate in Europe (60%).

India, the other major emerging market, dipped slightly in 2011 and will stabilise in 2012 under the impact of interest rates that have begun to become prohibitively high and the flop of the ultra cheap car. India nonetheless retains its long-term growth potential.

[1] Car ownership rate: number of vehicles per 1,000 inhabitants

The **Brazilian** market is also stabilising in 2011-2012 (+2% in 2012), due to the higher price of imported cars, which are heavily taxed, and to rising interest rates.

The **Russian** market continued to benefit from a car scrapping scheme in 2011 but growth is expected to come to a halt (0%) in 2012.

Very depressed from 2008 to 2010, the **US** market has been recovering since then thanks to vehicle replacement and is expected to grow by 8% to 10% in 2012.

After a catastrophic year, with a fall of 15%, in 2011, **Japan** will experience a technical rebound (8%) in 2012. This improvement will, however, be only temporary as the Japanese market is structurally declining over the long term and seems unlikely to return to its pre-crisis level in the foreseeable future.

Is the European automobile industry set to implode?

Car sales have continued to decline in **Europe** in 2011, particularly in the south. *"The European automobile market is unfortunately still far below its pre-crisis level, by at least 15%",* says **Ludovic Subran,** Euler Hermes' Chief Economist. *"Economic reality has naturally caught up with the market. With stimulus measures at an end and austerity now the watchword in most European countries, the automobile industry can only continue its slow agony and can be expected to contract by another 3% to 5% next year."*

"Very diverging trends are beginning to appear within Europe", he added. In the United Kingdom, Italy and Spain, the markets are still 20% to 50% below their pre-crisis levels and no rebound is expected in 2012. In Germany, however, the market is stabilising at a level close to that of 2008, with 3.1 million new car registrations forecast for 2012 (1.5% less than in 2011).

The French market continues to benefit from numerous car buyer incentives this year. However, according to **Yann Lacroix**, head of sector research at Euler Hermes, *"the market is experiencing difficulties. We are currently seeing a sharp downturn in order books which is expected to result in a 10% drop in growth in 2012, the sharpest fall in Europe. Moreover, profitability is low for French carmakers at 2.2%, one-third of the German level".*

The 2008-2009 crisis has therefore accentuated the relocation of automobile production to emerging markets, which will continue to drive growth in 2011-2012 even though they are also slowing somewhat. *"Carmakers face a number of major challenges. They must adapt their offer and vehicle ranges to the new demand from emerging countries and, at the same time, they can only achieve sustainable competitiveness if they step up the development of industrial partnerships, in both innovation and production. An example of this being the investment that is absolutely necessary to produce a profitable green car",* concludes **Wilfried Verstraete**.

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