

2008: a challenging year ahead for Australian vehicle sales and car production

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This series of reports analyses emerging trends in the Australian market for new motor vehicles. The last report was released in September 2007.

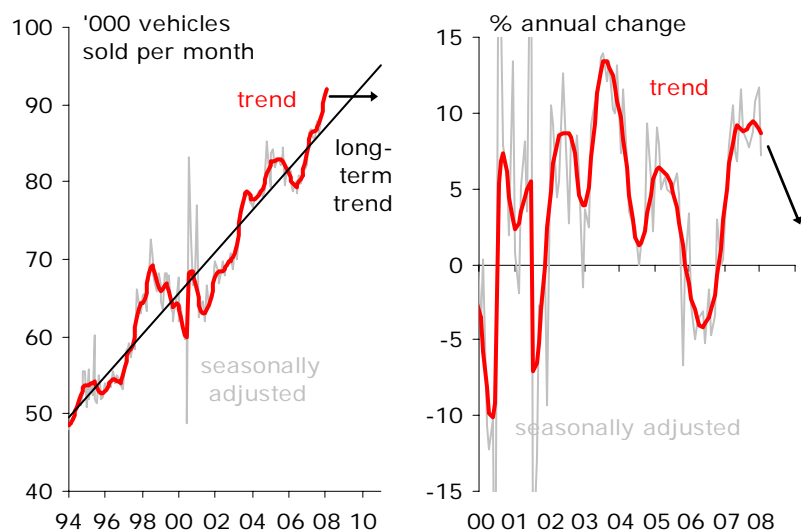
Key points

- The total number of registered vehicles driving on Australian roads is approaching 15 million, or more than 0.7 vehicles per person.
- 2007 saw very strong growth in new vehicle sales, with total annual new vehicle sales up 9.1%, to reach over one million for the first time.
- Market conditions continue to favour smaller passenger cars and SUVs over larger models, but larger commercial vehicles are faring well also.
- Australian-made vehicles continue to lose local market share. This will be compounded as our four local car makers shrink to three in 2008.
- The trend growth rate for vehicle sales appears to have already peaked in this growth cycle. Sales growth is decelerating and will be far weaker in 2008 than in 2007, as inflation and higher interest rates finally bite.

Broad sales trends

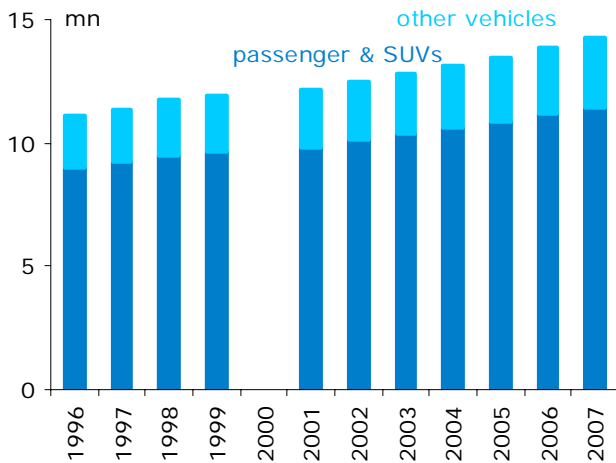
2007 saw growth of 9.1% taking total vehicle sales above one million for the first time. Sales growth was very uneven however, across vehicle categories and across types of buyers. Sales grew strongly from private buyers and businesses, but fell from government buyers. Similarly, growth was concentrated in a handful of vehicle categories, including light cars, sportscars, compact SUVs, PU/CC 4x4's and heavy trucks. After such a strong year in 2007, we expect 2008 sales to be slower, with further annual sales growth of only 1 to 2% by year end. Rising interest rates, persistent inflation and a less certain international business outlook are all likely to dampen enthusiasm for new cars (and for taking on new debt to finance them) among households and businesses alike.

Sales are above trend, but growth is set to decelerate in 2008



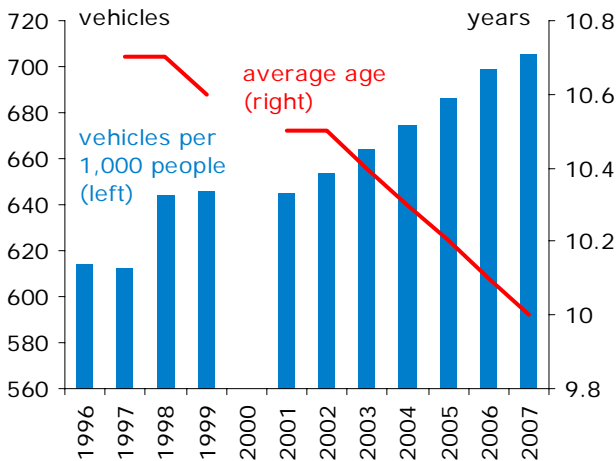
Sources: ABS 9314.0, *Sales of New Motor Vehicles*; Economics@ANZ

National auto fleet is now approaching 15 million



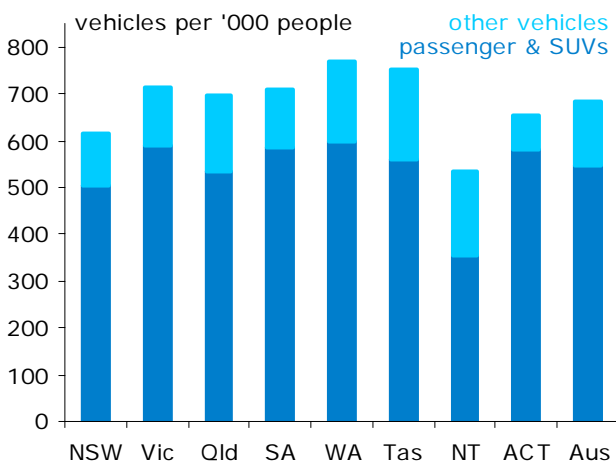
* Excludes motorcycles. No census undertaken in 2000.
Source: ABS 9309.0, Motor Vehicle Census

More vehicles per capita, newer vehicles on road



* Includes motorcycles. No census undertaken in 2000.
Source: ABS 9309.0, Motor Vehicle Census

More vehicles per capita in WA & Tas (2007)



* Excludes motorcycles.
Source: ABS 9309.0, Motor Vehicle Census 2007

Australia's automotive fleet

Number of vehicles

Australia had 14.774 million vehicles registered in June 2007. Annual growth in the total vehicle fleet has averaged 2.9% over the last 5 years. 78% of vehicles are passenger cars. The fastest growing vehicles categories over the last five years have been motorcycles (6.7% average annual growth), light rigid trucks (6.1%), campervans (4.3%) and light commercial trucks (3.8%). Passenger car registrations have grown 2.6% annual average.

This growth has been faster than general population growth, so vehicles per capita are rising too. Nationally, there were 705 registered vehicles per 1,000 people in 2007 (0.7 vehicles per person), equivalent to 1.04 per person aged 15 to 64 years. This included 547 cars, 105 light commercial trucks and 24 motorcycles and 2 campervans. Total vehicles per capita grew an average 1.5% per year from 2002 to 2007, to be up 7.8% from 5 years earlier and up 15.2% from 10 years earlier.

Vehicle registrations per capita vary across Australia, from 801 vehicles per 1,000 people in Western Australia down to 552 vehicles in the Northern Territory (2007). Tasmania and the Northern Territory have the highest proportions of non-passenger vehicles registered per capita.

Age of vehicles

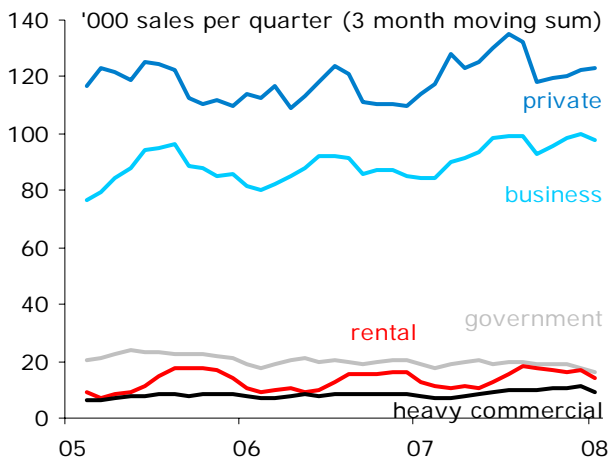
As the national fleet has grown, its average age has come down also. Passenger cars are now 9.7 years old on average, compared with 10.1 years old in 2002 and 10.5 years in 1997. Larger commercial vehicles tend to be older (15.7 years on average for heavy rigid trucks and 14 years for non-freight trucks), probably reflecting their high cost and the need to extract maximum commercial value.

The vehicles with the oldest average age by a long margin are campervans, at 18.6 years in 2007 (down from 19.1 years in 2002). Campervans have been growing relatively strongly and now number 43,266 registered nationally.

This reduction in average age has helped to improve the average fuel efficiency and emissions of our car fleet, although this benefit has not been enough to outweigh the increase in emissions resulting from more vehicles on our roads. Indeed, net greenhouse gas emissions from all Australian transport (including road, rail, air and sea) increased by 30% between 1990 and 2005, and produced 14% of the nation's total GHG emissions.¹ The Australian government recently pledged \$500mn to help the Australian automotive industry develop 'green cars' (see 'government policy and assistance' below).

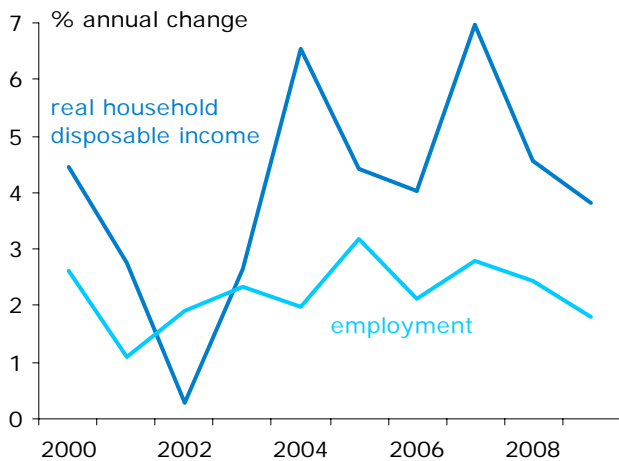
¹ Australian Greenhouse Office 2007, National Greenhouse Gas Inventory 2005.

New vehicle sales to the private sector grew strongly in 2007. Government sales fell.



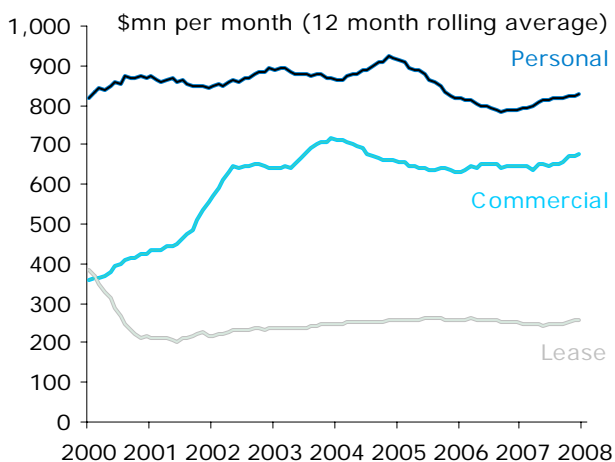
Source: FCAI

Car and SUV sales are supported by strong employment and household incomes



Sources: ABS and Economics@ANZ

Auto finance commitments up 5% in 2007*



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

Who is buying new vehicles?

In 2007, private individuals bought 48% of all new vehicles, businesses bought 36%, governments bought 8% and rental fleets bought 5%. Heavy commercial vehicles (large trucks and buses) are counted separately in these data, and account for around 3.3% of the total market.

Private buyers account for around 55% of sales of each of passenger car and SUVs, as well as 22% of sales of light commercial vehicles. Annual private vehicle sales grew 9% in 2007. They hit an all-time monthly record of 50,900 in June 2007, but subsequently fell back to an average of 40,000 per month in the second half of 2007. Private sales growth remained strongly positive going into 2008 but showed signs of decelerating from the highs of early 2007 (in annual growth terms). Household disposable income grew strongly in 2007 on the back of continuing employment and incomes growth, plus tax cuts in July 2007. Unemployment is now down to record lows and wages are creeping up across most industries. Going into 2008, growth in private vehicle sales is expected to slow as inflation and interest rate rises eat into household budgets.

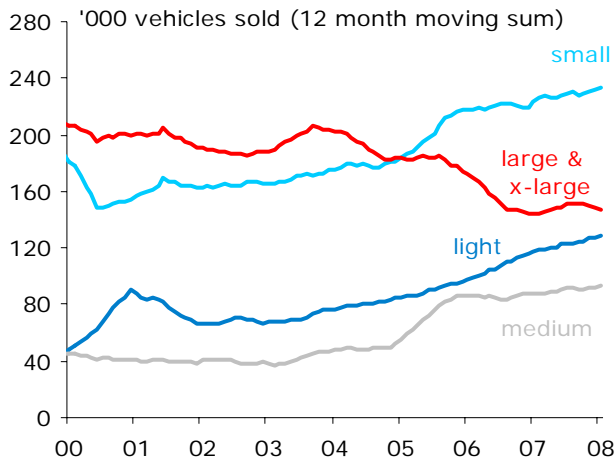
Businesses buy around 30% of passenger cars, 40% of SUVs and 65% of light commercial vehicles. Annual sales to businesses grew 10.5% in 2007. Sales accelerated through the second half of 2007 and remained strong right into January 2008. As for households however, inflation and higher interest rates will begin to eat into business budgets going forward, slowing the rate of growth in business investment, including growth in vehicle purchases.

Government (federal, state and local) is a small but crucial part of the new car market. In 2007, governments bought 7% of new passenger cars, 5% of new SUVs and 11% of light commercial vehicles. Traditionally, government purchases have been an important support for large passenger sedans such as those typically produced by Australian car manufacturers. Unlike the booming private sector however, annual vehicle purchases by government fell in 2007, by 4.3% from 2006 levels. This fall in sales accelerated though the year (in annual growth terms). Vehicle sales to government will continue to be weak in 2008, with the federal government looking to cut expenditure across all portfolios.

Rental fleet purchases of vehicles are highly cyclical, as rental operators must update their fleets to a relatively fixed schedule. Rental fleet purchases grew 12% in 2007 from 2006 levels.

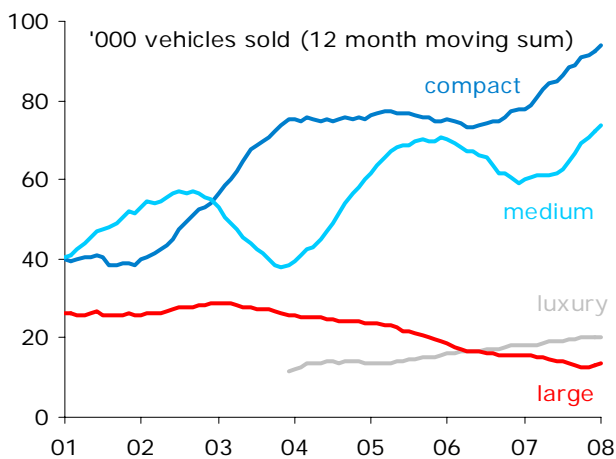
Looking at how new vehicle purchases are financed, over half of the total value of vehicle finance commitments is in the form of personal finance, with the remainder committed as commercial or lease finance. Total auto finance commitments grew 4.8% in 2007 (nominal average monthly value), with the strongest growth evident in commercial finance.

Customers prefer small and light passenger cars



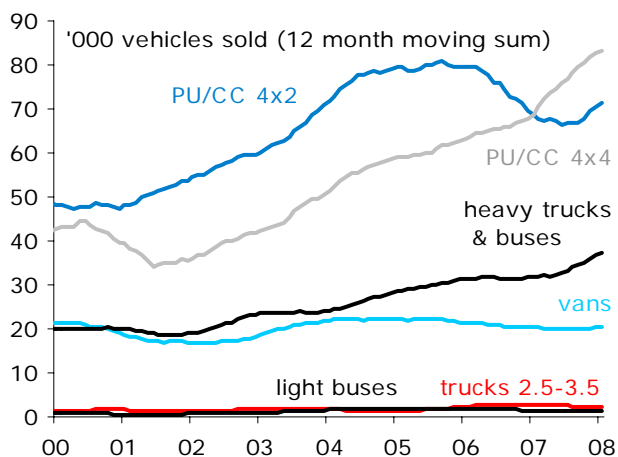
Source: FCAI

... and compact and medium SUVs



Source: FCAI

Heavy truck and 4x4 sales grew well in 2007



Source: FCAI

Which new vehicles?

Passenger cars accounted for 57% of vehicle sales in 2007, down slightly from 59% in 2006. This market share was lost to SUVs, which took a bigger slice of sales again in 2007 (19%, up from 18% in 2006). Commercial vehicles held a constant share of the market at around 20% of all sales.

Passenger cars and SUVs

The trend in consumer preferences toward smaller models of passenger cars that became evident five years ago continued through 2007. A temporary reprieve for large and extra large passenger cars through the first half of 2007 proved relatively short-lived, and sales declined again through the rest of the year. Annual sales of large and extra large cars for 2007 finished 2.2% and 2.7% higher than 2006. Monthly sales growth for large cars decelerated sharply through late 2007 (in year on year terms). Going into 2008, monthly sales for January were 20.9% lower than a year earlier.

Sales of light cars continued to grow through 2007, up 10.2% from 2006. Small and medium car sales grew by 6% each, and people movers grew by 5%. The surprise growth pocket for passenger cars in 2007 proved to be sports cars, which grew by 19% for the year. This no doubt reflects the strong growth in household disposable incomes evident across Australia in 2007. Ford has announced it hopes to claw back some of these 'luxury sports' sales to the large car category, with the release of the Ford FG Falcon, scheduled for May 2008.²

Similar consumer preferences are evident in the SUV market, with private buyers dominating both markets (although businesses buy a greater share of SUVs than of passenger cars). Annual sales of compact and medium sized SUVs grew 18.7% and 22.3% respectively in 2007, while luxury SUV sales grew 9.6% and large SUV sales fell 13.6%. The much-hyped arrival of the Hummer H3 in Australia added 273 units to 'medium' SUV sales in 2007.

Commercial vehicles, trucks and buses

Annual sales of light commercial vehicles grew by 9.7% and heavy commercial trucks grew by 17.7% in 2007, as business investment in new equipment and machinery grew solidly (up 6.7% in 2007). Virtually all the growth in light commercial vehicles was concentrated in the single biggest category, PU/CC 4x4's, with annual sales growth of 22.3%. Sales of all other categories of light commercial vehicle were flat relative to a year earlier. Heavy bus sales grew a whopping 25%, but total numbers remain small (under 1,000 units per year). Heavy truck sales grew an unexpected 17.5% in 2007 (after flat sales in 2006), reflecting stronger growth in activity and profits in the road transport industry.

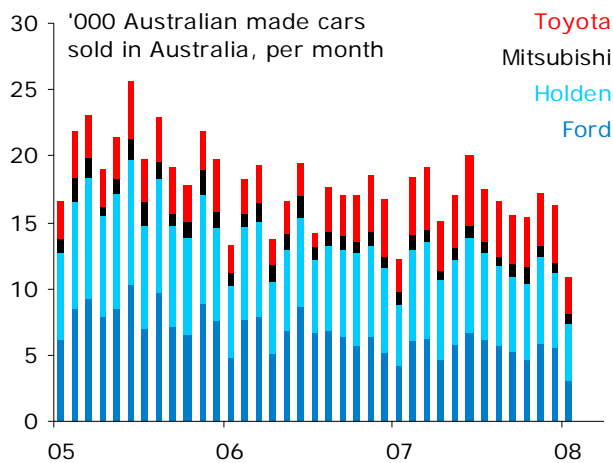
² "No flights of fancy at Ford's new Falcon launch", *Australian Financial Review*, 18 Feb 2008, p. 3.

Australia's favourite marques, 2007

Top 10	% of total auto sales	% of sales made in Aust.
Toyota	22.5	20.4
Holden	14.0	50.7
Ford	10.3	61.8
Mazda	7.4	-
Mitsubishi	6.2	16.7
Honda	5.8	-
Nissan	5.7	-
Hyundai	4.8	-
Subaru	3.7	-
Volkswagen	2.6	-
% of total sales	82.9	19.1

Source: FCAI

Sales of Australian-made vehicles keep sliding



Source: FCAI

Australian auto production hit a low in 2007. With Mitsubishi out, can it bounce back?

	Total Aust. Production	Aust. sales & market share
1980	364,033	365,334 (66%)
1990	381,780	361,494 (61%)
2000	345,207	247,187 (32%)
2005	388,985	248,912 (25%)
2007	327,984	200,507 (19%)
<i>FAPM forecasts (as of Oct 2007, excluding Mitsubishi) *</i>		
2008	357,876	191,876
2009	363,782	184,282
2010	382,102	197,102
2011	413,068	204,568

* FAPM forecasts exclude production and assembly of heavy trucks. Sources: FCAI; FAPM.

Australia's auto industry

Despite a booming year for car sales, Australian automotive production and local sales sank to a recent low in 2007, with just 328,000 vehicles produced and only 19% of local market share. Even for Toyota, Australia's top-selling marque and the largest local manufacturer, only one in five vehicles sold in Australia were made in Australia. More positively, exports are growing. In 2007, two thirds of Toyota's 140,000 Australian-made cars were exported, as were about 40% of Holden's 115,000 vehicles and 8% of Ford's 73,000 vehicles.

Mitsubishi, the smallest of the four local car makers, made just over 11,000 cars (the 380 sedan) in Australia in 2007. The 380 accounted for only 5% of Australian-made cars and 1.7% of all passenger cars sold in Australia in 2007. The 380's exports were even weaker, at around 300 units in 2007. Initial sales targets were around 30,000 annually.³ With such low sales, the 380 was apparently unviable. Mitsubishi is closing its Adelaide plant from March, directly affecting 980 employees plus up to 280 employees of its components suppliers. In an unrelated event in Sydney, National Parts (with 300 employees) entered administration in February.

Government policy and assistance

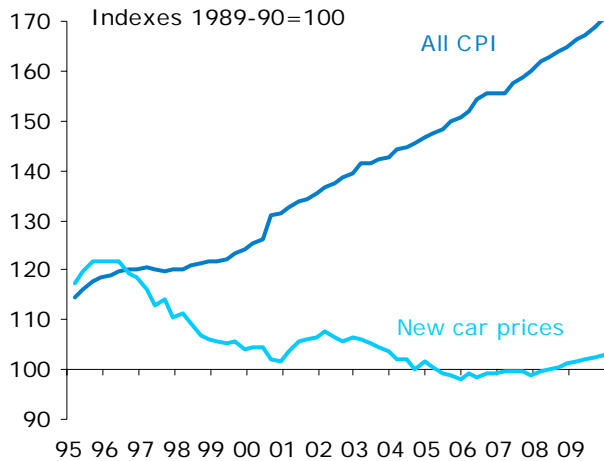
Australia's automotive industry has received high levels of financial and other assistance from governments over the decades, as it has struggled to keep pace with global industry, policy and trade changes. The most significant change has been the import tariff cuts that commenced in the 1980s under the 'Button Plan'. Import tariffs on passenger cars still stand at 10% (since 2005), but are scheduled to fall to 5% in 2010. The tariff on commercial vehicles and 4WDs is already 5%.

The exact amount governments have spent on assistance since the 1980s is unclear. 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 direct grants, subsidies, industry support measures and tariff equivalents. Additional (but confidential) assistance came from the Victorian and South Australian Governments in the form of payroll tax concessions, training assistance and "substantial" direct grants. In total, the Commission estimated an 'effective rate of assistance' of 30% of value added for the auto industry in 2001 (compared with 5% for all other manufacturing), reducing to 20% by 2005 (compared with 4% for all other manufacturing).⁴

And much more has been spent since. The current 'Automotive Competitiveness and Investment Scheme' is worth \$4.2bn (from 2001 to 2015).⁵

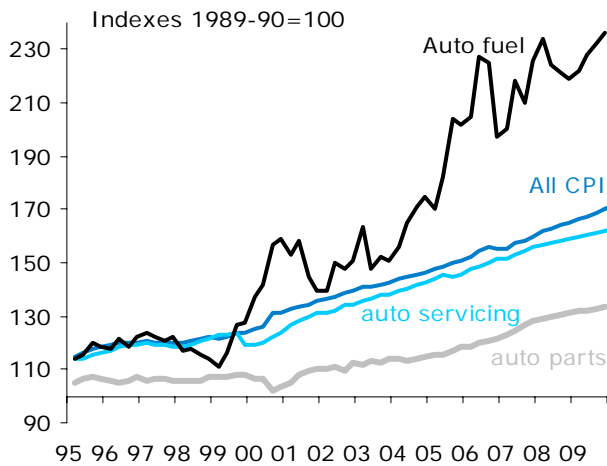
³ FCAI and FAPM.⁴ Productivity Commission 2002, *Review of Automotive Assistance*.⁵ Dept of Innovation, Industry, Science and Research.

New cars are now cheaper, more affordable



Sources: ABS 6401.0, *Consumer Price Index* and Economics@ANZ

Petrol has skyrocketed. Other car running costs are keeping pace with inflation



Sources: ABS 6401.0, *Consumer Price Index* and Economics@ANZ

Recent additional announcements include \$500mn for a 'green car innovation fund'; \$10mn to help Mitsubishi's 930 employees retrain and find new employment; and \$40mn for 'industry innovation'.

Industry Outlook for 2008

With the closure of Mitsubishi, Australia's automotive manufacturing industry is set to shrink further in 2008. In response, the Federal Government has announced a new inquiry into the viability of the automotive industry, to be headed by former Victorian premier Steve Bracks. It will report to the Government in July 2008. This will be the third national inquiry into the industry in a decade, with the Productivity Commission reporting on the auto industry in 1997 and again in 2002. Further assistance (and/or delayed tariff reductions) is likely to be recommended, because car manufacturing is still regarded by many policy-makers as a 'strategic' industry for employment, innovation and research purposes (although arguably, it lost that position some time ago), and because many other sectors supply and service it. It therefore remains central to Australian manufacturing policy. Any delay to tariff reductions however, will increase costs for purchasers of imported cars, who are now the majority of Australian car buyers.

New car prices

Nominal new car prices have fallen in the last five years (on an index basis), as a result of favourable exchange rates, a tariff reduction in 2005 (down to 10%) and a cut-throat, competitive international car industry, in which total production capacity exceeds global demand. As is the trend in many other industries, new auto production facilities continue to be built around the world, predominantly in lower-cost locations such as India, China and east Europe.

By 2006, nominal new car prices in Australia were similar to what they had been in 1989. In the December quarter 2007, annual inflation (CPI) was running at 3% and wages (WPI) grew by 4.2%, yet average new car prices *fell* by 0.5%. With household incomes rising strongly, new passenger cars have become much more affordable. This has no doubt encouraged recent sales and car ownership growth.

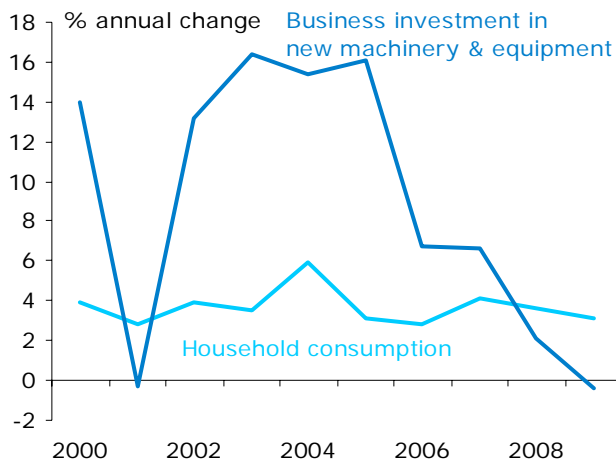
Petrol prices however, have risen sharply over the past two years. Other car running costs have also increased. The effects of these price trends are more evident in the type of vehicles being purchased, rather than in their absolute number.

Australian economic growth must ease in 2008

Annual growth %	2007	2008f	2009f
Aggregate income			
GDP	3.9	3.4	2.8
Employment	2.8	2.5	1.8
Unemployment rate (%)	4.4	4.2	4.2
Household disposable income	9.6	7.4	6.2
Aggregate expenditure			
Dwelling investment	4.4	2.2	5.6
Non-dwelling construction	17.7	6.3	5.0
Business investment in new machinery & equipment	6.7	2.1	-0.4
Household consumption	4.1	3.5	2.5
Household savings ratio (%)	2.7	4.0	5.3
Prices			
Wages (WPI)	4.1	4.3	4.2
Consumer Price Index (CPI)	2.3	3.7	3.2
RBA cash rate, year end (%)	6.75	7.50	7.50

Source: Economics@ANZ (forecasts at 21 February 2008).

2008: household and business spending are at record levels, but growth is set to decelerate



Source: ABS and Economics@ANZ

Weaker sales growth expected in 2008

Total vehicle sales	2006	2007	2008f
Number	962,666	1,049,982	1,060,480 to 1,070,980
Annual growth %	-2.6	9.1	1 to 2

Sources: FCAI; ABS; Economics@ANZ.

Sales outlook

Australia's economy is set to grow strongly again in 2008 — in many ways, too strongly. The economy is hitting serious capacity constraints in the labour market, transport infrastructure and other hotspots. The RBA remains nervous about the outlook for inflation (which has moved well above its target range of 2 to 3%) and is expected to raise interest rates to at least 7.5% by the middle of the year. Worsening volatility in international financial markets is complicating this growth story, by raising the cost of credit and increasing the uncertainty surrounding key economic variables such as export commodity prices and the Australian dollar.

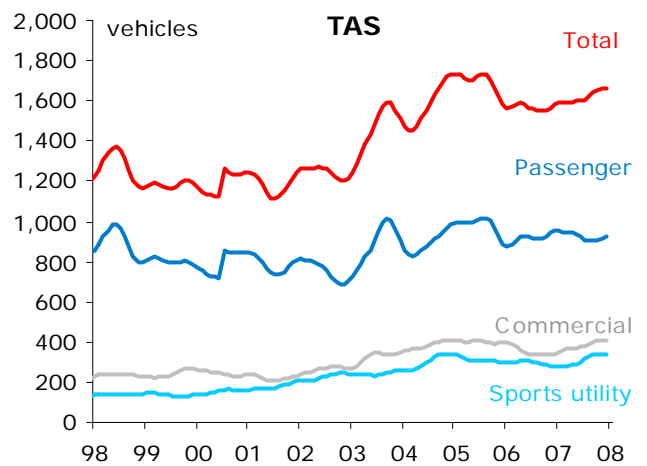
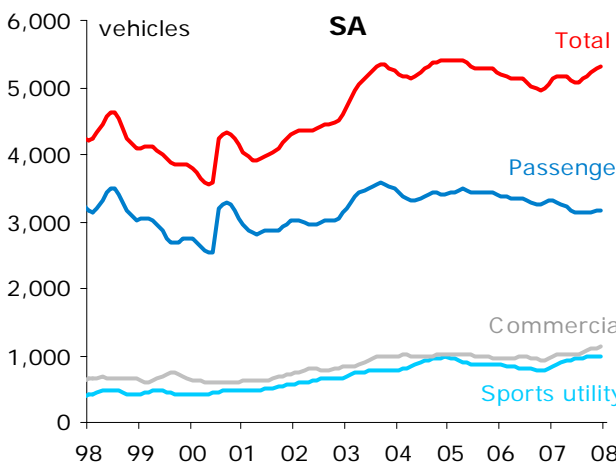
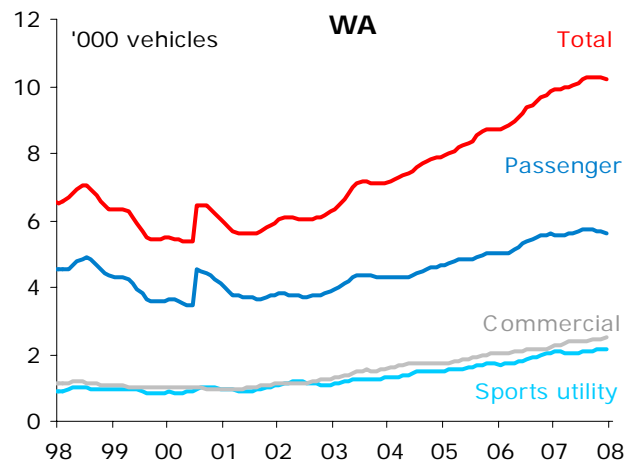
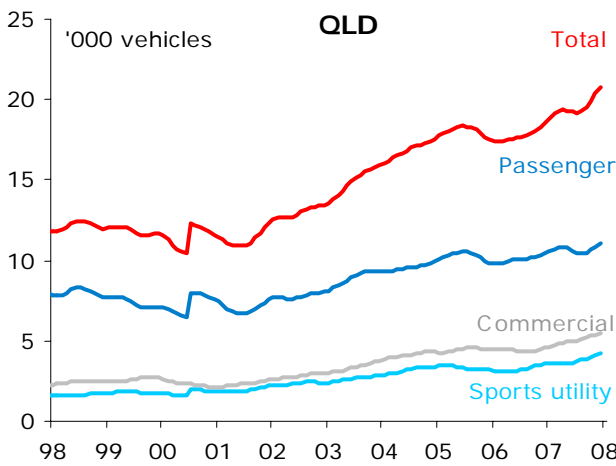
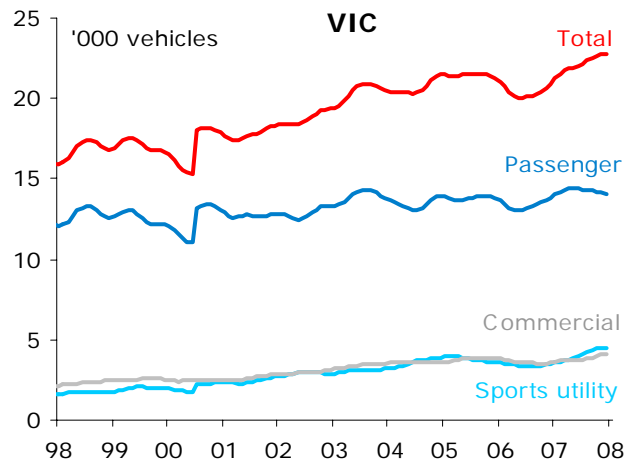
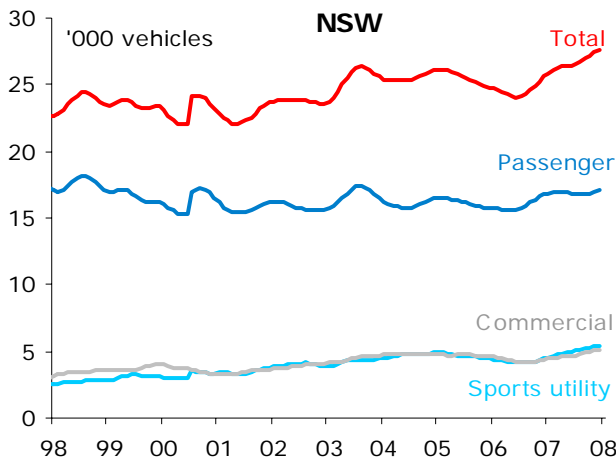
For private households, 2008 will bring another boost to incomes through sustained employment and wages growth, plus further tax cuts from July 2008. Real disposable incomes and growth in household consumption will be eroded however, by persistent inflation of around 4%, plus interest rate rises of at least another 50bp (taking the cash rate to 7.5%). Households facing higher mortgage bills and/or higher prices for essentials will be looking to reign in discretionary spending, including spending on their next new car — it will need to be cancelled or, more likely, postponed. Higher interest rates will also dissuade households from taking on more debt for new cars. In this environment, another year of 9% growth in private car sales seems very unlikely.

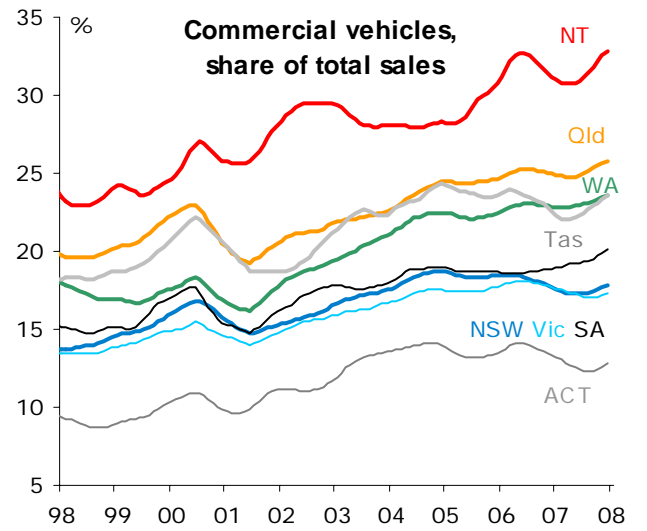
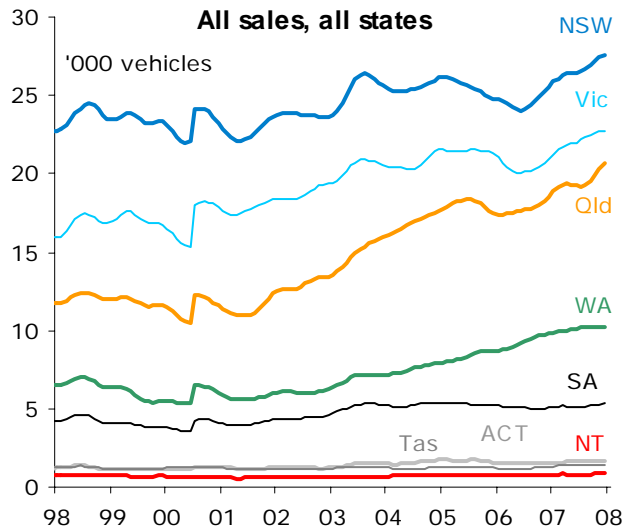
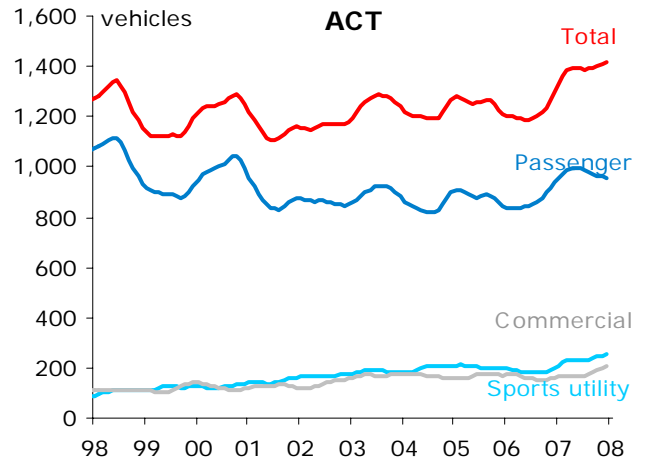
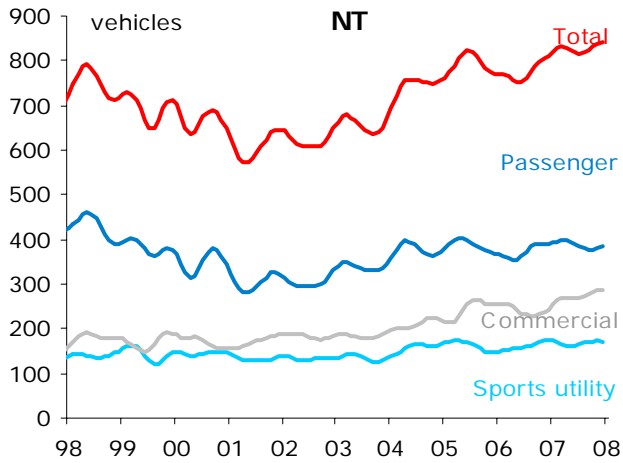
Business investment in equipment and machinery (including vehicles) has grown spectacularly over the last 5 years, reaching record levels of around \$20bn per quarter by June 2007. The investment growth cycle has peaked however, and is now decelerating. In 2008, further growth of around 2.2% is expected on top of current record levels. This is still positive, but well down on recent growth rates of over 6%, and miles from the peaks of over 16% in 2003 and 2005. By 2009, business investment in machinery and equipment can be expected to actually shrink from its current highs. This slowing in the investment cycle through 2008 can be expected to extend to purchases of vehicles, with much slower sales growth expected as a result.

Vehicle sales to governments are also expected to slow in 2008. With the Rudd Government slashing budgets across all portfolios, new vehicle orders from Federal Government departments are more likely than not to be cut.

Adding all of these contributing factors together, 2008 is shaping up to be a much weaker year for vehicle sales than was 2007, despite a seemingly robust domestic economy. Indeed, the trend sales growth rate has already turned south. We expect annual sales for 2008 to finish up only 1 to 2% higher than the record sales achieved in 2007.

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





Source: ABS 9314.0

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