Cyclical Shock or Permanent Decline for West European Car Markets?

Colin Couchman
Director, Europe
European Synopsis — Near & Mid-Term

- Economic view—substantial slowdown in W. Europe with consumers deeply unsettled
- Oil price compounded by faster rise in refined diesel
- Car markets have only just started their slide
- Cost increases still to pass through to consumers
- Complex and costly legislative regulations yet to hit
- Longer term impact of current cyclical developments?
- Car production—Western European plants partly insulated by growth in Central / East European markets (esp. Russia)
Anatomy of Crisis and Requirements for Recovery

Factor Index
Q1 2007 =10
Un-weighted, Judgemental Metrics

We Are Here

- Bad News Flow
- Raw Material Price Feed
- Credit Crunch Libor+
- Policy Interest Rate
- Inflation
- Oil/ Energy Prices
- Unemployment
European Car Market Downturn

• **Cyclical Factors**
  – Credit Crunch / Financial Crisis induced
  – Indirect effect of lower U.S. & global economic growth rates
  – Temporary inability to respond with lower interest rates
  – Slump in consumer confidence after a spring of consistently bad news-flow

• **Also ‘Long Cyclical’**
  – Housing Market correction

• **How much is Structural?**
  – Depends on Oil Price
  – Depends on Financial Markets
  – Depends on Start of a New Modal shift
  – Depends on Legislation/Taxation
Abrupt Downshift in Selling Rate Reflects Consumer Pessimism

For Q1-Q3 ’08 around \( \frac{2}{3} \) of decline oil price related
From Q3 ’08 around \( \frac{2}{3} \) of decline credit crunch
Carmakers push becoming less effective
If oil price fails to weaken situation could worsen…

Quarterly market “push”
Consumer Sentiment as Bad as Early 90’s Recession

Only hope for Q4 is that sentiment has been over-pessimistic and stabilises with retreat of oil price & action on financial crisis.
W.E. Car SAAR — Confirms Abrupt Downshift

(Trends in West European New Car Registrations - Sept'2008)

Monthly evolution of the annualised rate in 000s

Note: Last Data Point
September 2008
Major deterioration in new car sales began in late May/early June and plummeted in August (Average YTD9 -5.1%)
West European Car Sales (YTD September 2008)

Demand decline not yet broad based but has been asymmetrical. France and Germany counter cyclical (so far).

Average YTD Growth: -5.1%
Fundamental Floor Analysis

• Very Different Macroeconomic Outlook
  – Slower GDP growth
    • Short-term hard and fast economic slowdown
    • Lower trend level of GDP for longer term
  – At best “less easy” access to finance
    • Worst case sees significantly tougher credit restrictions

• Household Dynamics
  – Incomes and wealth
  – Flip in asset buoyancy (was appreciating now deflating)
  – Affordability suffers
  – Is it back to “saving up for stuff”?

• Base Level Scrapping Demand
  – Provides floor to the market
• Auto financing practices are still very different across Europe
• But probably 60% to 80% of new private cars are bought using some form of credit requiring financing
  – Private Loans 35%
  – Car Loans 50%
  – PCP, Lease with Purchase option 15%
• Captive financing 25%-30% of sales (v. important for earnings)
• Sub Prime financing at POS is probably below 5% (e.g. U.K.)
• ‘Upside down’ and ‘walk away’ not European issues (repo)
• Equity withdrawal (mortgage top up schemes) likely to be slashed
• ‘Low-Down’ is going up (bigger deposits, stricter credit checks)
• Credit offers are being rationed right now
• Non-private demand around 40% of market
Prevailing Demand Conditions

- Financial crisis well documented but where’s it going to end?
- Recession of early 1990’s provides some clues
  - 1990’s car demand slumped to 11.5m (this time we expect 12.9m)
  - Cannot compare on simple volumes terms as relative wealth of European households has grown over past 15 years
  - For example, several million more households have the theoretical potential to purchase new cars
  - Also the pool of replacement demand is higher (annual scrapping around 12million about 2–3m higher than 1990s)
  - Markets such as Germany and France are providing support
  - Spain, U.K. and Ireland closest to recession (so far)
  - Unemployment is rising—has risen in each of past 5 months
- We can compare underlying ratio of car sales to households (with income over $20k p.a.)
Ratio of New Car Sales to Number of Households with > $20k Income (real 2000) European Big 5 Markets

Ratio of new car sales to number of households could fall below 1993 recession levels due to lack of accessible credit.

Slow recovery
Market support level is a lot higher than back in the early 90’s.
## Cyclical and Structural Impacts on Affordability

<table>
<thead>
<tr>
<th>Fundamental Drivers</th>
<th>Recent Past (up to 2007)</th>
<th>Cyclical (S/T)</th>
<th>Structural (L/T)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Rates (financing)</td>
<td>“Easy terms”</td>
<td>--</td>
<td>-</td>
</tr>
<tr>
<td>Disposable Income Growth</td>
<td>Good</td>
<td>--</td>
<td>-</td>
</tr>
<tr>
<td>New Car Prices</td>
<td>€</td>
<td>€€</td>
<td>€€</td>
</tr>
<tr>
<td>CO₂ Abatement Tech Load</td>
<td>Benign</td>
<td>=</td>
<td>-</td>
</tr>
<tr>
<td>Legislation (inc. new taxes)</td>
<td>Benign</td>
<td>- / +</td>
<td>-</td>
</tr>
<tr>
<td>Running Costs (fuel / tax)</td>
<td>Not a deal breaker</td>
<td>- / =</td>
<td>=</td>
</tr>
<tr>
<td><strong>Affordability (function of above)</strong></td>
<td>Good</td>
<td>--</td>
<td>-</td>
</tr>
</tbody>
</table>
Pure Raw Material Cost in a Car

Series based on Global Insight Cost Analysis Service—Spot Prices

$ / €

Steel
Aluminium
Plastic Resins
Rubber
Glass
Iron

July 08

European Car in Euro's
US Car in $

(Excludes Fuel, Processing & Transportation costs)
Implications of Current Cost Increase

...Assuming Full Material Cost Increases Are Passed On

<table>
<thead>
<tr>
<th>Per Vehicle</th>
<th>Europe</th>
<th>U.S.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost increase</td>
<td>220 Euro</td>
<td>$800</td>
</tr>
<tr>
<td>% Selling price</td>
<td>+1.1%</td>
<td>+3.5%</td>
</tr>
<tr>
<td>Impact on sales</td>
<td>-0.8%</td>
<td>-3.3%</td>
</tr>
<tr>
<td>Change in manufacturing costs</td>
<td>+4%</td>
<td>+10%</td>
</tr>
</tbody>
</table>

Recent Fall in the Euro will amplify the pressure in Europe

* Change in Costs in March ‘08 vs. Long Run Average
Estimates Based on Prices of $23K for U.S. & €20K for Europe
Evolution of West European Car Sales Forecast

Recent past: robust demand supported by “low risk” borrowing on back of low interest rates and inflation supported by asset inflation (esp. equity withdrawal)

Demand slide: consumers unsettled by oil price, inflation & especially credit tightening
Rising raw material costs putting pressure on new car prices
Also CO₂ abatement costs in run up to 2015 deadline
Short Term Forecast for Western Europe

- **Sep-08**
- **Credit Freeze Scenario**
- **Interim Oct 08**
## Factor Exposure Matrix (Big 5)

<table>
<thead>
<tr>
<th>Big 5 Markets</th>
<th>Housing Bubble</th>
<th>Sub Prime Issue</th>
<th>Reliance Credit / Finance</th>
<th>Interest Rate Sensitivity</th>
<th>Fuel Price Sensitivity</th>
<th>Company Cars</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>O</td>
<td>O</td>
<td>O</td>
<td>Low</td>
<td>Low</td>
<td>+</td>
</tr>
<tr>
<td>U.K.</td>
<td>−</td>
<td>−</td>
<td>−</td>
<td>High</td>
<td>Low</td>
<td>+</td>
</tr>
<tr>
<td>France</td>
<td>O</td>
<td>O</td>
<td>O</td>
<td>Low</td>
<td>High</td>
<td>O</td>
</tr>
<tr>
<td>Italy</td>
<td>O</td>
<td>−</td>
<td>−</td>
<td>Med</td>
<td>High</td>
<td>O</td>
</tr>
<tr>
<td>Spain</td>
<td>−</td>
<td>−</td>
<td>−</td>
<td>Med/High</td>
<td>Med</td>
<td>O</td>
</tr>
</tbody>
</table>
Car demand has not retrenched in wake of credit crisis (YTD +1.3%) Note VAT distortion 2006-07

CO₂ taxes coming Jan ’10 “Normal” longer term trend worries ageing population & shrinking workforce
New Car Market Forecast — France

Recent French demand has been low compared to trend level.

“Eco tax” helped for 2008 as bonus effectively lowers new car entry price.

Car Sales (Millions)


-4% 0% +1.0% +3%
Recent past no longer a good indicator of future demand as rose to unsustainable trend level (bubble)

Housing market overhang
De-leveraging consumers
Very young car parc
Wealth Effect
Financial turmoil hits City
Weaker £ hurts prices, importers & profits
2008 extension to 2007 incentives (Deadline March ’09)  
Jul & Aug saw SAAR below 2.0m

H2 2008 credit squeeze  
Q4 should see incentive rush  
‘09 all about financing / econ  
BUT always the possibility of another incentive round
New Car Market Forecast — Spain

Recent past no real helps to size future demand as overshot trend

Housing market overhang
Wealth effect
Young car parc
VIVE incentives
Lower trend GDP growth

Car Sales (Millions)


-16%  -24%  +9%  +9%  +15%  -16%  -24%
Other Western Europe — Selected Demand Drivers

- EU Structural Funds (past)
  - PRT, GRC, IRL
- ECB & euro (esp. I/Rate)
  - IRL, PRT, GRC
- Income Tax Reforms
  - SWE, DNK & FIN
- Fiscal Tightening
  - GRC, PRT
- High Car Tax Markets
  - DNK, SWE, NOR & FIN
- Inward Investment
  - IRL
- Overheating esp. housing
  - IRL, DNK & SWE
- EU Enlargement
  - AUT & IRL
- Globalisation
  - SWE, FIN, IRL
- Banking & Credit Crisis
  - ALL
New Car Market Forecast — Central Europe

Car Sales (Millions)

- SLOVENIA
- SLOVAKIA
- ROMANIA
- POLAND
- MALTA
- LATVIA
- LITHUANIA
- HUNGARY
- ESTONIA
- CZECH REP.
- CYPRUS
- BULGARIA

Years: 1996 to 2015
Trend Level of West European Market

Car Sales (Millions)

- Late 80's Boom Time
- Early 80's Recession
- '93 Recession
- '00's "Toxic Shock"
- 70's Oil Shock

Prolonged Current Cycle Reflects Pressured Consumer Sector
Cyclical upturn starts only in mid 2010...
W.E. Structural Trend Level is being lowered

Demand Destruction While De-leveraging Impedes Recovery
GM cutting back Astra output at Ellesmere Port despite reduction in Astra production at Antwerp

Further UK cuts Bentley, Ford, JLR, IBC Luton & Nissan

Honda Swindon moving one assembly hall to single shift & extending Christmas shutdown

Toyota scaling down output at Burnaston due to lower demand; removing 1 of 2 Auris shifts

Renault has imposed three-day weekends at Douai since July; Working hours cut at Sandouville

PSA reducing Poissy output by 50% in Q4 and transferring employees in Rennes from 407 and C6 lines to C5 line, but still laying off 100 people

Volvo terminating night shift at Torslanda in October instead of in December in response to deteriorating markets (also deep white collar cuts)

BMW slowing output at Dingolfing, Regensburg & Leipzig

Mercedes adjusting output down 45,000 units - initially models popular in N.A. such as E-Class & S-Class but now also C-Class

VW Group cutting shifts in Bratislava, Poznan, Martorell, and at Skoda

FIAT closing four of its five plants for at least three weeks each by the end of 2008 and is expected to announce further stoppages at Pomigliano (Alfa Romeo)
Slump in Production Will Intensify and Spread East

Brutal Near-Term Outlook for Car Production

E.Europe  W.Europe

Copyright © 2008 Global Insight, Inc.
Capacity Utilisation Rates — West European Plants

- 0% - 100%
- BMW, Daimler, VW, Ford, GM, Fiat, PSA, Renault
- 2008 vs 2009
**European Light Vehicle Production by Country**

- **WE:** Minimal output growth only because of Germany
- **EE:** Blanket gains (2.3m) - Russia, Czech Republic, Turkey, Poland, Slovakia, Romania, Ukraine, Hungary, Serbia etc
- **Russia:** overtook Italy in 2004, will be 4th from 2008; Slovakia expected to move into 10th position in 2009
Cyclical Shock or Permanent Decline?

- **Cyclical Shock Should Unwind from H2 2009**
  - Oil prices receding
  - Pump prices should follow (esp. if diesel refining capacity rises)
  - Central Banks beginning to reflate & inflation fears declining
  - 2009 should witness bottom of the car demand cycle (12.9m units)

- **Permanent Impact on Car Markets**
  - Financial crisis will leave longer term legacy
  - Cost of credit to rise / access to borrowing to fall
  - End of “funny money” & risk taking lending culture
  - Lower level GDP across forecast
  - No quick fixes for housing markets
  - Ratchets up pressure on vehicle affordability & relative ease of car ownership
  - Demand destruction means lower trend level of car sales
  - Low-no growth outlook at best for most car markets
Thank You!

Colin Couchman
Director, Europe
colin.couchman@globalinsight.com