Italian car sector: Time to do an oil change

October 22, 2014

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Executive summary

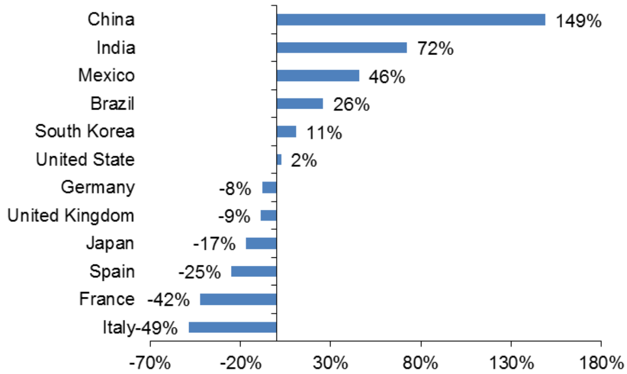
- Car registrations went up by +3.5% in the first nine months of 2014, after six years of decline and hitting a 35-year low, and Euler Hermes expects +3% for the whole year.
- Passenger car production is expected to increase by +3-4% in 2014 and 2015. A small but welcome increase, as production dropped to 380 000 units in 2014 from 900 000 in 2007 and nearly 1.5 million units in 2000.
- Car components are showing stronger prospects. The recipe? 70% of the companies in the sector are exporters with a track record of innovation and technological superiority.

The global automotive industry in a nutshell

The automotive industry closed 2013 with record global sales. Last year, 85.4 million new cars were sold and robust growth has continued through 2014 (with a closing estimate of 88.8 million). This trend is driven by the emerging markets in Latin America and Asia, where one in every two cars is assembled. Balances have changed dramatically, and China has firmly established itself as the leading car market, while Europe has dropped from 32% of world production in 2008 to 24% in 2014.

On the flipside, car sales reflect the economic difficulties faced across the globe; recovery is slow in Europe, the United States is better off but jobless, Japan is crutched on public support and in emerging countries development is slow, despite high expectations. Overcapacity continues to be high, putting profit margins under steady pressure. Production growth in the global automotive industry is set to stay around +4% y/y in 2014 and 2015, increasing in China, India and Mexico to the detriment of Europe. Production should exceed 100 million cars by 2017.

Chart 1: World automotive production, country change (in millions of units)



Sources: OICA, Euler Hermes

Italy: Car registrations hit 35 year low at 1.3 million units in 2013 but show signs of modest recovery in 2014

The Italian automotive sector has faced continued difficulty and car registrations entered their sixth consecutive year of decline in 2013 (around 1.3 million in 2013, down -7% from 2012). Registrations have not been this low since 1979. The economic crisis and high maintenance costs (taxes, fuel and insurance) are holding back the use of cars, a sort of *demotorization*, reducing the number of cars in circulation. In support of this view, data for 2013 shows a negative balance between registrations and scrapped cars of approximately 100 thousand.

In the first nine months of 2014, car sales and revenue were half of those in 2007 at EUR 23.7 billion (compared to EUR 44.9). The number of car dealers decreased from 3 thousand to roughly 1,7 and an additional decline by 15 to 20% is expected up until 2020. While sales to private individuals in Italy were steadily above 70% until 2007, they are now less than 60% of total sales.

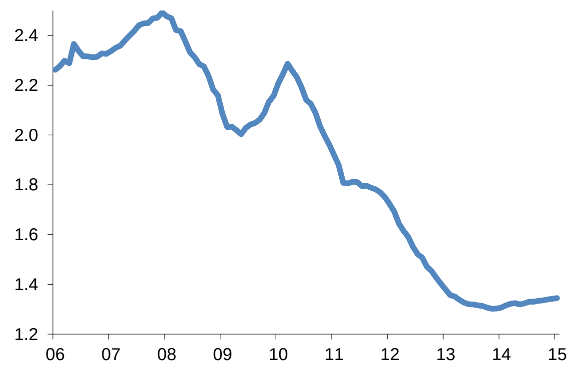
The inescapable aging of vehicles in circulation in Italy – 12 years 2 months for gasoline cars and 7 years 7 months for diesel cars– should support the demand for new vehicles, although modestly as other factors such as a remarkable decline in traffic induce consumers to postpone or limit servicing as much as possible. Moreover, attention on service and product quality with respect to price is increasing, thanks in part to the wide availability of information.

In any case, the future is not yet rosy for sector operators, as demonstrated by recent cuts in GDP growth forecasts by the Italian government, Euler Hermes expects -0.3% GDP growth in 2014 and +0.3% in 2015. In the first 9 months of 2014, Italian new car registrations showed encouraging signs and should rise to 1.35 million, an estimated +3% annual increase with +5% in 2015, but remain very far from the pre-crisis level of around 2.5 million units. Nevertheless, volumes are at a record low and still suffer from the effects of past scrapping schemes. The vehicles registered since 2000 account for 71% of those in circulation, of the total 44% were registered after 2005. The Italian government has indicated that purchasing incentives are not a current priority, extending those for green cars only until 2015, whose market impact is limited.

Italian production hits a low note: 380 000 units in 2014 from 900 000 in 2007

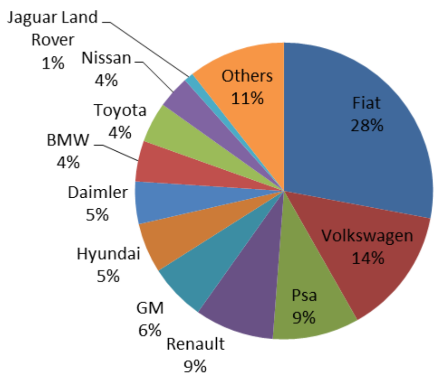
The Italian automotive sector (final assemblers and component, distribution, car dealerships and repair shops) accounts for 12% of GDP, contributes 17% to domestic tax revenues and employs more than 1 million workers.

Chart 2: New cars registration in Italy 12 rolling months, (in millions of units)



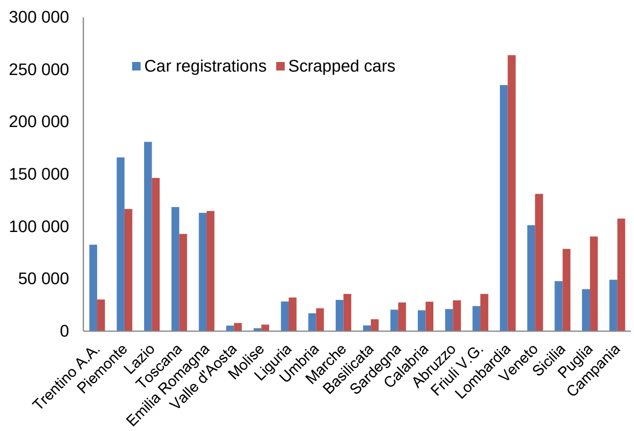
Sources: ANFAC, Euler Hermes

Chart 3: Market share by group in Italy (Jan. to Sep. 2014)



Sources: UNRAE, Euler Hermes

Chart 4: Registrations and scrapped cars in 2013 by region (number of units)



Sources: Continental study, Euler Hermes

The production of passengers cars decreased year after year to less than 380 000 units in 2014 from 900 000 in 2007 and nearly 1.5 million in 2000. The five leading Italian car factories are remarkably underused and production has seemingly stabilized at 380,000 cars in 2014, with +3% growth. Tangible recovery in the short run is unlikely, with only +5% growth in 2015 with 416 000 cars. The new business plan announced by Fiat management, in particular for Alfa Romeo (estimated annual sales of 400 000 cars in 2018 compared with 74 000 as of now) and Maserati will need time before new models are launched.

The transport sector trade balance was positive for the first seven months of 2014, with cars leading both exports (up +11.3% totaling 3.5% of exports) and imports (+13.5% and 5.1% share of total imports). Trade flows to some countries like Spain have increased by more than 50%.

Components: a glimmer of growth for the Italian automotive industry

The car components sector, composed ofroughly 2 500 companies, devotes 2.5% of revenues to R&D, a crucial factor together with aggregation and internationalization. One third of the sector along with half of their sales and workforce are located in the Piedmont region, but they extend significantly to Lombardy, Veneto, Emilia Romagna and Melfi (Basilicata).

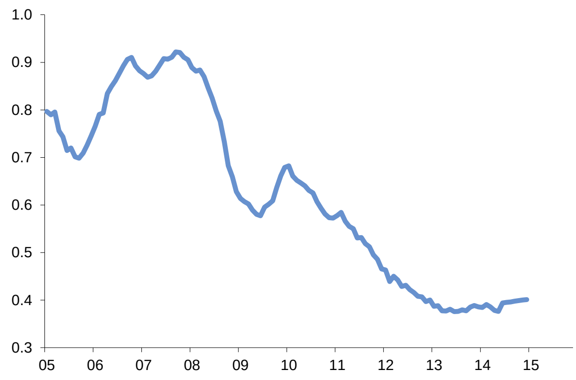
The sector is divided into segments (basic sub-suppliers, specialized makers of single parts such as brakes, module makers, etc.) at different levels of quality. Using technologies (such as die-casting and mechanical processes in general) which were on the verge of abandon, components makers produce parts for domestically based foreign carmakers targeted to the up-market segment.

Within the sector, 70% of companies are exporters and their export propensity exceeds 50% of revenues. As a whole, car components accounted for 4.9% of all Italian exports and 3.1% of total imports in 2013. The upward trend of exports continued through the first half of 2014 propelled by the excellent result of engines despite the decline in tires. Western Europe absorbs approx. 50% of exports, with Germany as the main supplier and buyer of car components, followed by France at 13.7% and 11.1% respectively.

First-installation components have provided some relief to the whole sector, having closed 2013 accounts with positive results (+2.7% vs. 2012) reporting strong growth in foreign markets (more than 19 billion euros, +5.7%), which also reigns true in 2014.

The sector has remained competitive in mature markets due to the expansion of productive investments abroad, cost cutting and increased distribution efficiency. Inside the car components sector there is another significant niche for Italy, where the country is the undisputed leader: leather items for car upholstery with a significant number of specialized industries in Lombardy and Emilia Romagna.

Chart 5: Production in Italy, 12 rolling months (in millions of units)

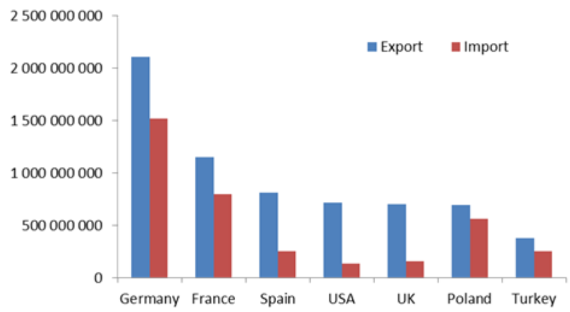


Sources: ANFAC, Euler Hermes

Chart 5: Domestic car production, monthly figures (in units)

Sources: Continental study, Euler Hermes

Chart 6: Main countries for Italian auto components export H1 2014 (Euros)



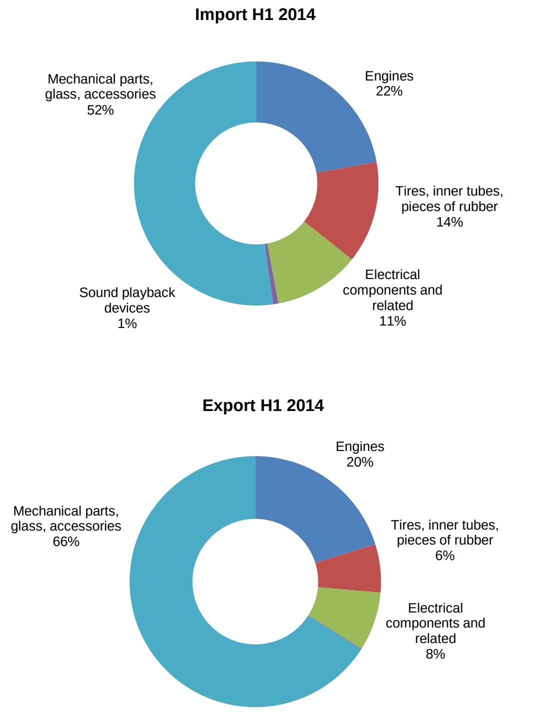
Sources: ANFIA, Euler Hermes

Sector weaknesses still include the dependency on Fiat, which endangers the survival of small businesses, the non-saturation of plants and a high level of debt (with financial costs that reach, in many cases, up to 40% of operating profit), which does not seem to improve. Stocks are already at minimum as big players have been reducing them using a just-in-time strategy, causing high market fluctuations.

The arrival of emerging countries on the international scene either as producers or consumers has convinced component makers that production cannot be restricted to Italy. In the last two years, the producers (mostly big, but also small) have opened factories on all continents, involving not only first-line suppliers but also specialists, the second line of subcontracted suppliers. Three in five producers have touched down in emerging markets, with a focus on the East (China), while good prospects are opening up in Bulgaria and North Africa (Morocco). Others have been acquired by German groups. However, there is a multitude of small and medium-sized businesses which, lacking such strength, are exposed to failure unless they find foreign competitors interested in the Italian know-how, an asset not easily replicated.

Volume increases, economies of scale, market and production globalization are all essential drivers of change together with technological progress led by research and innovation. The connectivity components market is exemplary of this, which will sprout up in the next few years mostly thanks to software and telecommunication companies. Connectivity component technology, an awaited middle term project (5-10 years) would enable vehicles to automatically react to surrounding traffic.

Chart 7: Imports and exports by component for the first half 2014



Sources: ANFIA, Euler Hermes

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