Sector Insight:
Indian Automobile Sector Slowdown

September, 2019

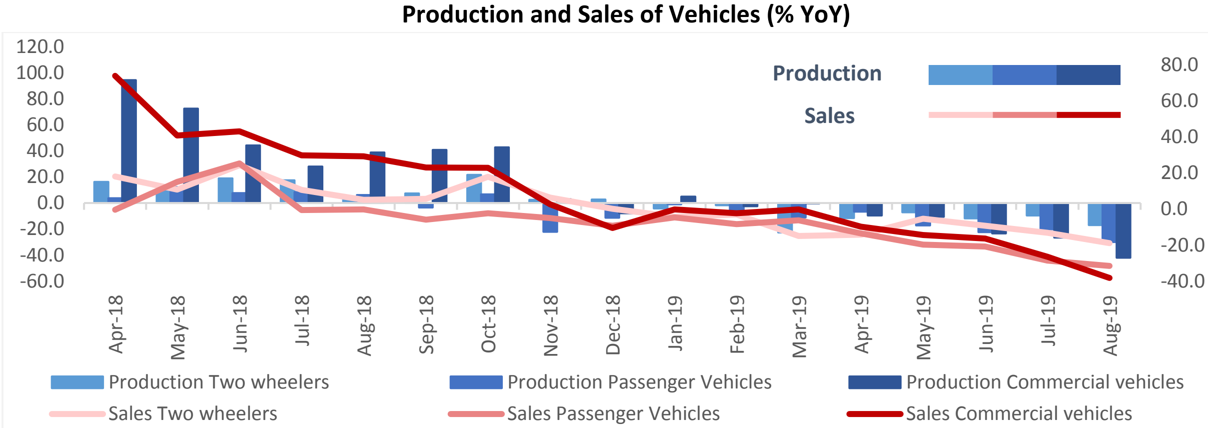
Indian automobile industry, which is valued at around Rs. 4.8 lakh crores, contributes about 7.5 percent to the country's overall GDP. The industry is one of the biggest employment generator in the country and is currently employing about 37 million people (including direct and indirect employment).

Globally, Indian automobile industry became the fourth largest in the world (excluding two wheelers) in 2017 and was the seventh largest manufacturer of commercial vehicles in 2018.[1] India is renowned as a global hub for frugal and scalable automobile engineering. India's automotive sector offers significant cost advantages and has an edge over other countries in terms of requisite manufacturing infrastructure and low labor costs. As a result, domestic firms save about 10-25 percent on operations vis-à-vis Latin American and European nations. In terms of volumes, Indian automobile industry is a global leader in two wheelers segment, segment A cars and tractors.

In the domestic market, India's automotive manufacturers have been very successful across segments with rising income levels of India's demography. The growing middle class bulge, increasing rural and urban demand has consistently added and supported the growth of sector in the country.

Current Trends in the Automobile Industry: A Historic Slowdown

The Indian automobile industry has witnessed a discernible slowdown and some really worrying numbers have come to fore over the past few months. While the moderation had been building up for almost a year now, the latest sales numbers indicate deceleration touching historic lows. Sales across all major segment including passenger cars, commercial vehicles, two wheelers, tractors have reported a significant decline. For instance, the latest numbers report a decline of 30.6 percent in August in passenger car sales – which has been the worst performance in over two decades.



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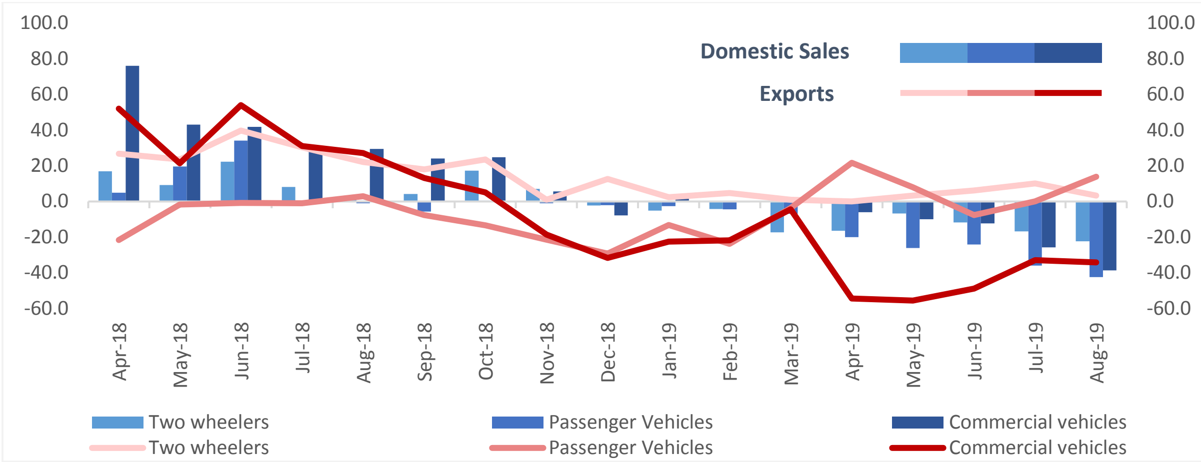
[1] https://www.ibef.org/industry/india-automobiles.aspx

Domestic Sales vs Exports (% YoY)



Source: CMIE

Between the years 2016 and 2018, three key shocks spelled turbulence for the overall economy and the automobile sector was also impacted to some extent. The first tremor came in the form of the demonetization announcement on November, 2016; the second, through the implementation of Goods and Services Tax in July 2017 and the last and the most recent one was the NBFC crisis (August/September 2018). While all of these events had some repercussion on the automobile sector, it was the liquidity crisis following the IL&FS fiasco (accompanied by a slew of other factors) that triggered a conspicuous slowdown in the sector.

Data released by Society of Indian Automobile Manufacturers shows that, so far, about 2.3 lakh jobs have been lost in the sector and about 300 auto dealerships have been closed in the recent past. Also, several major players have been announcing non-working days to better manage excess inventory and an increase has been noted in the number of non-working day announcements by companies.

In fact, estimates report that earlier this year the inventory levels touched a peak 50-60 days for passenger vehicles, 80-90 days for two-wheelers and 45-50 days for commercial vehicles. This was a significant deviation from the ideally defined level of three weeks/21 days of inventory. At present, except for the car segment, the inventory levels for two-wheelers and commercial vehicles continues to be high. Average inventory for passenger vehicles has reportedly come down 25-30 days in July 2019 on back of production cuts and cut in dispatches to dealers. Nonetheless, average inventory for two-wheelers is still about 60-65 days and commercial vehicles about 55-60 days.

Passenger Vehicles:

Passenger vehicle sales plummeted 30.6 percent y-o-y in August 2019 vis-à-vis 0.3 percent contraction noted in the same month previous year. This marked fourteenth straight month of decline and is the steepest fall in about two decades. Domestic sales took a beating with the segment contracting by a whopping 41.1 percent in August 2019. However, exports of passenger vehicles performed much better despite the glut facing the industry. Export of passenger cars noted a growth of 13.9 percent during the month. Sales of vans also witnessed a sharp decline of 46.6 percent in August 2019.

Passenger Vehicles: Domestic Sales & Exports – Growth in %

	Mini & compact cars		Super compact and mid-size cars		Executive cars (4501-4700 mm)		Premium cars (4701- 5000 mm)		Vans	
	Domestic Sales	Exports	Domestic Sales	Exports	Domestic Sales	Exports	Domestic Sales	Exports	Domestic Sales	Exports
Aug-18	1.0	13.7	-13.0	32.1	-52.2	na	-45.7	na	2.4	392.9
Jul-19	-36.7	-17.5	-26.9	80.7	-6.4	na	-32.8	na	-45.7	4.8
Aug-19	-39.5	-4.6	-57.6	35.7	-32.3	na	-4.1	na	-47.4	-16.7

Source: CMIE
na: not available

Commercial Vehicles:

Commercial vehicles segment sales declined by a sharp 38.3 percent y-o-y in August 2019 vis-à-vis 29.3 percent growth reported in the same month previous year. This was the ninth consecutive month when the segment noted a decline. Both exports and domestic sales of commercial vehicles contracted during the month.

Commercial Vehicles: Domestic Sales & Exports – Growth in %

	Medium & heavy commercial vehicles		Light commercial vehicles		Multi utility vehicles	
	Domestic Sales	Exports	Domestic Sales	Exports	Domestic Sales	Exports
Aug-18	28.6	53.4	30.3	6.7	-7.1	21.2
Jul-19	-37.5	-48.6	-18.8	-17.2	-15.2	-20.2
Aug-19	-54.3	-53.3	-28.2	-12.8	-2.2	18.3

Source: CMIE

Sales of medium and heavy commercial vehicles contracted by 54.2 percent in August 2019 as compared to 28.6 percent growth recorded in August 2018. Revised axle load norms in July 2018 which increased the official maximum load carrying limit by 20-25 percent has played its role in restricting demand of heavy vehicles. Further, scrapping of mandatory annual renewal of fitness certificates for freight carriers has also limited the scope for fresh sales picking up as it has given fleet owners the opportunity to utilize their existing assets more instead of purchasing new trucks. Light commercial vehicle sales dropped 28.2 percent in August 2019 as compared to 30.3 percent growth noted in August 2018.

Two & Three Wheelers:

Of all the auto categories, two-wheeler segment is highest in terms of volume with a major chunk of demand coming from the rural areas of the economy. The segment is largely driven by the amount of disposable income available which in turn is a function of agricultural and allied sectors' growth. Ongoing rural and agrarian crisis has worsened the outlook for this segment. Two wheelers sold in August 2019 fell by 18.9 percent y-o-y while sales of three wheelers contracted by 8.7 percent during the month.

Two Wheeler & Three Wheeler: Domestic Sales & Exports – Growth in %

	Motor cycles		Mopeds		Scooters		Three wheelers
	Domestic Sales	Exports	Domestic Sales	Exports	Domestic Sales	Exports	Domestic Sales
Aug-18	6.2	21.1	-13.5	-18.2	-0.6	29.8	23.0
Jul-19	-18.9	12.1	-23.7	236.9	-12.1	-3.4	-7.7
Aug-19	-22.3	6.3	-21.3	77.5	-22.2	-15.4	-6.9

Source: CMIE

Even though domestic sales of both two and three wheelers was weak in August 2019, export growth of two wheelers segment remained in the positive terrain. Two wheelers reported 3.3 percent growth in outbound shipments in August 2019, vis-à-vis 10.1 percent growth in July 2019 and 22.2 percent growth in August 2018. Deeper penetration of Indian companies in markets of Africa, Latin America and ASEAN nations has helped keep external demand for two wheelers upbeat.

Company Wise Performance- Automobile Industry (% YOY)

Company		Jun-19		Mar-19		Dec-18	
	Rank by size	Net sales	Net profit (PAT)	Net sales	Net profit (PAT)	Net sales	Net profit (PAT)
Maruti Suzuki India Ltd.	1	-12.2	-27.3	1.4	-4.6	2.0	-17.2
Tata Motors Ltd.	2	-19.9		-3.2		1.5	191.9
Mahindra & Mahindra Ltd.	3	-4.4	89.5	5.5	-19.9	12.9	-11.4
Hero Motocorp Ltd.	4	-8.9	38.3	0.8	-12.1	7.5	-4.5
Bajaj Auto Ltd.	5	3.9	0.9	-7.9	-24.5	16.0	15.7
Ashok Leyland Ltd.	6	-9.2	-45.4	9.3	20.9	-12.0	-21.5
T V S Motor Co. Ltd.	7	7.2	-2.9	9.4	-19.2	26.1	15.6
Eicher Motors Ltd.	8	-7.6	-15.7	-1.2	84.7	3.6	6.2
Force Motors Ltd.	9	-9.8	-34.1	1.9	-35.3	9.9	86.6
S M L Isuzu Ltd.	10	4.2	-17.2	16.7	48.0	4.6	-

Source: CMIE

Is the Slowdown in Automobile Industry Cyclical or Structural?

Worsening trade wars among the biggest economies, uncertainty around Brexit and rising geopolitical tensions have been roiling the global economy and India has not been unscathed. Moreover, international crude oil prices, a complementary commodity for the auto sector, has been witnessing frequent shocks on back of growing geopolitical concerns in the Middle East. Multilateral agencies have already downwardly revised their global growth and trade forecasts for 2019 which is also corroborated by slower growth in many industry segments worldwide including the automotive industry.

Slowdown in Auto Sector: India vis-à-vis World (Sales growth)

	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19
India	**-0.4%**	**-1.9%**	**-1.1%**	**-3.0%**	**-17.1%**	**-20.5%**	**-17.5%**	**-31.0%**
China	-13.0%	-15.7%	-13.7%	-5.1%	-14.6%	-16.4%	-9.6%	-4.3%

Indonesia	3.2%	-15.4%	-13.5%	-11.4%	-17.8%	-16.3%	1.2%	-
Malaysia	-11.9%	8.7%	-1.8%	9.6%	6.2%	41.4%	-34.0%	-
S. Korea	2.5%	0.2%	-4.4%	-4.4%	3.2%	-1.4%	-8.5%	-
Thailand	8.9%	17.3%	9.1%	8.5%	8.7%	3.7%	-2.1%	-
Mexico	-10.8%	1.8%	-5.5%	-1.5%	-10.5%	-11.2%	-11.4%	-7.9%
Brazil	9.8%	8.7%	25.2%	-0.2%	5.5%	20.1%	9.5%	11.4%
W. Europe	-8.6%	-5.0%	-1.6%	-3.8%	-0.9%	-0.6%	-8.3%	-
US	1.4%	-1.6%	-3.3%	-2.9%	-2.0%	-0.3%	-2.5%	2.1%
Japan	1.7%	2.1%	1.2%	-4.0%	3.4%	6.5%	-0.7%	4.1%

Source: Bloomberg

Even though India is not isolated as far as the downturn of the automobile industry is concerned, the magnitude of the slowdown has been sharper than many other countries, especially in Q1 2019-20. A combination of factors has adversely impacted supply as well as demand of vehicles in the economy. Shocks in the form of new safety norms, taxation and regulatory changes together with economic factors in 2018 majorly impacted the supply side. While moderation in wage growth, the liquidity crisis had an impact on the demand side.

Switch to BS VI norms…

Regulatory mandate of switching to BS VI engines and fuel norms from April 2020 has significantly increased costs for the industry. Estimates indicate that the industry will have to invest Rs. 70,000 crore upwards to comply with policy shocks on the emission norms front. Also, the consumers are in a watch mode and have deferred their purchases until 2020. Vehicle prices are expected to go up next year and will impact the demand. Product readiness, supply chain readiness and dealership readiness will be critical going forward.

NBFC crisis…

Given that a chunk of vehicles bought are financed, demand for vehicles was hit hard as the NBFC crisis in September 2018 exacerbated the liquidity crunch in the economy. It is important to note that NBFCs support bulk of finance for the automotive industry. Auto loans account for about 30 per cent of NBFCs' assets. In fact, NBFCs in recent years have funded nearly 55 per cent-60 per cent of new and used commercial vehicles. NBFCs have been very aggressive in lending to the rural sector and semi-urban areas, especially to farmers, daily wagers, and small servicemen.

New Insurance Norms…

New insurance norms mandating third party insurance cover to be paid upfront for a period of three years for passenger vehicles and five years for two wheelers has raised on-road price for the respective segment for consumers – thereby impacting demand. The net outflow on account of premium payment will be more in the first year. Instead of making annual premium payments, the TP premium will have to be paid as an upfront-lump sum payment.

New rules of third-party motor insurance for new cars* : Impact - Who pays more, who pays less				
	Existing tariff (annual)		New tariff (One-time)	
	April 1, 2018 to March 31, 2019	Total Outflow	April 1, 2018 to March 31, 2019	Difference (Rs)
Not exceeding 1000 cc	1850	5550	5286	Rs 264 lesser
Exceeding 1000 cc but not exceeding 1500 cc	2863	8589	9534	Rs 945 extra
Exceeding 1500 cc	7890	23670	24305	Rs 635 extra
All figures in Rs				
* Long term premium rate for 3 year TP (Sept 1,2018 to March 31, 2019)				

Consumer Confidence muted…

As per RBI's latest Consumer Confidence Survey, the sentiment with regard to discretionary spending remains weak. Consumers are believed to be deferring purchase of high valued products on the back of gloomy outlook on the disposable income front. While urban India is facing a difficult job market, the rural economy has been impacted by severe distress in the agriculture sector.

Perceptions and Expectations on Spending- Non-Essential Items **(Percentage responses)**

	Current Perception				One year ahead Expectation			
Survey Round	Increased	Remained Same	Decreased	Net Response	Increased	Remained Same	Decreased	Net Response
Sep-18	44.0	34.3	21.7	22.3	49.2	33.3	17.5	31.7
Nov-18	39.1	37.6	23.3	15.8	44.5	35.9	19.6	24.9
Dec-18	38.4	37.5	24.1	14.3	46.1	33.0	20.9	25.2
Mar-19	36.3	43.3	20.4	15.9	46.1	37.6	16.3	29.8
May-19	32.7	40.3	27.0	5.7	39.4	37.3	23.3	16.1
Jul-19	31.0	44.9	24.1	6.9	36.2	42.2	21.6	14.6
Sep-19	29.9	40.0	30.1	-0.2	34.7	39.2	26.0	8.7

Source: RBI

Tech Disruptions…

Tech disruptions and shared mobility have also dented demand in the passenger car segment, especially in the urban markets. Growing usage and expanse of cab aggregators has made traveling easier as cars are available on demand. This has been a huge disruptor in the car ownership space with millennials now opting for cab rides offered by aggregators such as Ola and Uber rather than opting ownership of a car. Declining data costs in India has helped many low income users to come online and mid-income users to stay online for prolonged duration. This has facilitated growth of on-demand taxi market in India. Alongside, sales potential to cab aggregators might have now matured with demand further falling.

Making electric vehicles the new norm…

Moreover, policy announcements such as moving to 100% electric cars in India by 2030 and banning of diesel vehicles sent shivers down the auto industry besides creating confusion about the life span of internal combustion engine vehicles in the minds of the consumer. The announcement has deeply hit the industry.

Revision in axle load norms…

In the commercial vehicles space, revised axle load and hike in prices by manufacturers have played their part in squeezing demand of such vehicles. In July last year, the government increased the official maximum load-carrying capacity of heavy vehicles by 20-25 percent with the objective of bringing down logistics costs. Moreover, elimination of multiple check posts under the GST and e-way bill regime have reduced the overall time of completion of trips by about 30 percent, thereby reducing demand for more vehicles to cater to existing transport needs.

Volatility in oil prices…

Petrol and diesel prices do have an impact on the sale of automobile vehicles to some extent. The two are complementary products and therefore, there's always been some impact of petroleum prices on automobile sales**.** According to a study undertaken by E&Y in 2018, fuel cost accounts for 20-50 per cent of the cost of vehicle ownership in India, depending on distance travelled per day. The study assumes fuel cost of Rs 6 per kilometer, which has since increased.

Market Dynamics in the Used Car Segment

At a time when the market for new vehicles is facing a severe downturn, the used car market is actually witnessing a boom. The pre-owned car market is now larger than the new car market. According to a report by IndianBlueBook (a used car pricing guide by Mahindra First Choice Wheel), 3.6 million new cars were sold as compared to 4 million second-hand cars that were bought and sold in 2018-19.

The most important factor that drove buyers to the used car segment vis-à-vis new cars was the pricing of each segment. According to the report, getting good value for money was the topmost reason for buyers to move to the used cars segment. This was especially true given that the value of a car depreciates significantly in the first year itself – and up to 50 percent for some models.

New Cars vs Used Cars- A comparison

Parameter	New Car	Used Car
1. Market formalization level	Highly formalized.	Largely unorganized/ informal. However, it is moving towards more organized levels.
2. Price satisfaction	High prices.	Good value for money, both for buyers as we as sellers. Buyers, in particular, find the segment more affordable than purchasing a new car.
3. Car financing	About 75-80% buyers finance their cars.	Only about 17% of used cars get financed.
4. Drivers of growth	Demand driven. Greater demand will induce greater supply.	Largely supply driven.

Source: IndianBlueBook, Various press articles

While the above factors were playing their role in diminishing demand for automobiles, manufacturers continued to pump supply of automobiles leading to excess inventory pile up. This has hurt dealers the hardest. As demand failed to pick up even during the festive season in 2018, a supply glut got created which has led auto companies to cut production at their factories.

Some of the factors discussed above have a cyclical undertone, however to get out of the current situation it is important that we keep the focus on structural adjustments that will have to be undertaken. It is only through a process of continuous adjustment to the structural factors that we will be able to sustain the optimism in India's automotive sector.

Outlook

India's auto sector is expected to recover and grow robustly given its inherent strengths. Large domestic consumer base with rising middle class, lower overall cost of production owing to low labor cost and availability of infrastructure are core strengths that support the industry. External markets in developing nations like Africa, Latin America and ASEAN region also continue to hold good potential given the rising consumer base.

The government's initiatives further support optimism around the industry's long-term growth. In fact, the automobile sector is one of key focus sectors identified under the Make in India campaign of the government.

Moreover, Government of India along with the Indian Automobile Industry had come out with an Automobile Mission Plan 2026 which envisages the Indian automotive industry among the top three of the world in terms of engineering, manufacturing and export of vehicles and auto components by 2026.

In addition, going forward a higher GDP growth, stable prices, greater availability of credit and financing options and a large young population will continue to support the growth of this sector. Moreover, greater focus on overall infrastructure/logistics development will bear fruits for the industry.

Taking cognizance of the current situation, the government recently announced measures to give some thrust to the sector. These were all welcome decisions. The decisions such as - deferring revision of one-time registration fees till June 2020, higher depreciation on all vehicles till March 2020, clarification on the operational period of BS IV vehicles as well as greater overall clarity on electric and internal combustion engine compliant vehicles and allowance to government departments to purchase new vehicles by replacing old ones - are likely to aid the auto sector's recovery. Also, the government's announcement of withdrawing the deadline of converting to e-vehicles will come as a much-needed respite for the industry.

While these measures are encouraging, a lot more needs to be done to revive auto sector.

First and foremost, there is a need to pep up overall consumption spirit in the economy which has taken a beating in the current economic and liquidity scenario. The government is working on making the economy, especially the rural sector, more buoyant. To attract low-middle income segments of the society, there is a need for adapting to the special needs of low cost and robust vehicles in the rural areas. This will enable growth in the auto sector which in turn will lead to greater economic growth and job creation.

Alongside, measures must be taken to ensure adequate availability of liquidity in the credit system. Simultaneously, steps are needed to bridge the trust gap between lenders and borrowers amidst the trust deficit created after the rising non-performing loans came to fore.

Second, the government must ensure a robust and coherent policy frameworks with roadmaps for smoother transition to any regulatory changes rather than depending on judicial intervention like the ban imposed by the apex court on registration of BS III vehicles. A clear roadmap on the policy front will enable greater innovation with the industry preparing themselves better for the new challenges. In this regard, it will be useful if a single authority for technical regulations is set up for the auto industry as the regulations governing the industry would be more inclusive on say safety, emissions and fuel efficiency front. Currently, diverse viewpoints from multiple ministries and authorities on the regulatory aspects of the industry are often contradictory to each other creating confusion. This not only weakens the implementation of the policy, but also impacts outcomes. A single implementing authority would create a far more predictable, consistent and systemic regulatory environment which would further enthuse the industry to focus on planning and undertaking long term investments to make India an automotive hub.

Third, there is also an urgent need to come out with an integrated Incentive based Scrappage policy covering all segments of the Auto Industry. Vehicle scrapping policy is essential to take old polluting vehicles off the road and replace them with vehicles possessing newer and cleaner technology. This will enable larger sales of vehicles.

Four, While EVs must be promoted with full effort, there are many signals emanating from the government actually discouraging the customer not to buy ICE vehicles. Most recently, MORTH has released a draft notification proposing an increase in registration fee on ICE vehicles by 733% in private cars and 900% in taxis. Such policies can inflict major damage to automobile sales and must be avoided.

Five, the automotive industry must focus on utilizing the new round of opportunities that are emerging in the BS-VI and electric vehicle space. Government's focus on building smart cities and on improving road infrastructure will establish new avenues of growth which must be timely seized. Moving towards low carbon transport is the future of transport systems around the world and quicker adoption by utilizing various schemes provided including the low carbon transport scheme, green urban transport scheme, FAME scheme can provide an edge to Indian automotive manufacturers in the global market.

Six, provide a temporary benefit to this sector by reducing GST rate to 18% on vehicles and thus enabling the clearance of stocks before the BS-VI regulations kick in from April 2020.

Even though the industry is going through a trough currently, the future of automotive industry in India looks bright. Furthermore, in India, only 22 people out of 1000 own a vehicle as compared to 980 in the US and 850 in the UK per 1000 population. As the economy moves towards the five trillion US Dollar mark by 2025, the middle class in the country is expected to expand further which is likely to give a boost to automobile demand.

On the external front, India has a great opportunity to diversify its market share globally. Domestic automobile manufacturers must expand their base not only in new emerging market economies to capitalize on their growth prospects and rising middle class population but in advanced countries as well to cater to high end vehicles demand.

The Indian automotive industry has a strong hold and is expected to tide over the current situation in the coming months.

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