Signals from the Car Market

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The poster child of India's economic reform, the refurbished and once rapidly growing passenger car industry, is experiencing a downturn. February was the fourth consecutive month when sales of passenger cars fell relative to the corresponding month of the previous year. India's largest producer, Maruti Suzuki, is reported to have experienced a 10.9 per cent decline in domestic sales month-on-month over a year, with aggregate sales falling by a lower 7.9 per cent because of some increase in exports. This downturn is more or less generalised, affecting products in almost all segments, excepting a very few.

The downturn was not confined to Maruti alone, with other major manufacturers like Hyundai Motor India and Tata Motors also recording a decline in sales. Though some smaller manufacturers, especially in the SUV and luxury segments, have reported an increase in sales, the overall picture is one in which the industry's much-scaled-down estimate of 0.1 per cent growth in passenger car offtake this fiscal year is unlikely to be realised. According to the Society of Indian Automobile Manufacturers (SIAM), passenger car sales declined by 1.80 per cent during April to January of this financial year relative to the corresponding period of the previous year. With sales over the whole financial year expected to fall by even more, this could prove to be the worst year experienced by the industry in at least the last ten.

The decline was largely unexpected, with industry sources initially projecting a 3 per cent growth in sales over the year. But, looking back the deceleration in growth seems part of a medium term trend. Between 2005-06 and 2010-11, which covers most of India's high growth era, passenger car sales grew at a scorching 15.2 per cent per annum. That had fallen to 4.7 per cent in 2011-12, before collapsing this financial year. Not surprisingly, manufacturers seem to be overcome by the fear of a recession.

That fear is visible in the industry's responses. Tata Motor's, for example, has offered to buy-back after three years its sedan named Manza from its customers at 60 per cent of the purchase price. This offer is in addition to a Rs. 50,000 drop in price. It has also launched a scheme whereby buyers of its small car, Nano, can swipe credit cards issued by six major banks and avail of staggered payment plans. Other companies, such as Toyota, Honda and Volkswagen, are also offering discounts and various incentives in response to poor demand.

Finally, in a more telling move, Maruti Suzuki India suspended production for a day at its Gurgaon plant, which is capable of delivering upwards of 3000 units everyday. With sales declining, inventories have been piling up, warranting the step. " We already have over a month's inventory with us and want to adjust our stocks according to demand in the market," a senior Maruti Suzuki executive is reported to have said. This despite the fact that the company's plant at Manesar had been shut for a month in July-August last year on account of a protest by labour that led to violence. This would have kept the company's production well below potential during the financial year.

All this is occurring at a time when the government has launched on a programme of hiking petrol and diesel prices repeatedly to bring them on par with international levels. Though many car buyers may not be deterred by the cost of operating a vehicle, some may, especially at a time when other factors are dampening the enthusiasm of potential buyers. In particular, the rising cost of diesel may dampen demand for SUV's, sales of which had held up during the recent downturn. The other segment of demand that has held up is the luxury market. But that seems too small to neutralise the decline in the mid- and lower-price segments.

For a government already concerned over the deceleration in GDP growth to an estimated 5 per cent in 2012-13, this news must be troubling. India's passenger car industry has not only been among the few high performing segments of Indian manufacturing, but reflects much of what the government claims economic reform was expected to deliver: new products, better technology, some exports and competition that keeps prices down. A setback here means much more than a small dip in a single industry.

Moreover, the downturn in the passenger car segment perhaps has something to say about the sustainability of India's high growth story. It is now well established that a factor driving demand and sales in this industry was access to credit. Being a commodity that has resale value and can therefore serve as collateral for the loan financing its purchase, the automobile is a prime candidate for debt finance. Being a durable that is desired by the middle class in a country with poor public transportation, it is also a commodity for which pent up demand is substantial. Not surprisingly, after loans for housing, one area in which personal loans have increased substantially is for purchases of automobiles, resulting in a rapid increase in vehicle ownership. This factor, more than just easy availability, were principally responsible for the explosion in demand once access to debt increased.

The decline in demand may be because the credit-driven growth in sales is proving difficult to sustain. Credit financed demand growth is predicated on confidence: confidence among lenders that they are not expanding the universe of borrowers to an extent where the proportion of potential defaulters exceeds some critical level; and, confidence among borrowers that they are not taking on interest and amortisation payment commitments (combined in the equated monthly instalment) that may prove too difficult to meet. Periods when the economy is booming boosts such confidence, leading to excess credit offtake. This in itself soon saps confidence, especially if the increased exposure of banks leads to a rising default rate. Reportedly that has happened in India. If in addition the boom comes to an end, as it seems to have judging by GDP growth figures, confidence is further undermined. Default rates also rise. The latter worsens confidence unleashing a downward spiral. That is what seems to be happening currently.

This experience is of significance because debt financed expenditure has played a crucial role in the post 2003 boom that the Indian economy has experienced. Between then and 2010, the ratio of credit advanced by commercial banks to GDP rose from around 25 per cent to well above 50 per cent. Since this was the period when GDP was rising at 8 per cent or more per annum, this did imply a huge increase in outstanding bank credit over a short span of time. This was also the period when the share of retail credit—personal loans of various kinds—more than doubled to reach 23 per cent of total advances. The two sectors that benefited most from such lending were housing and automobiles.

Credit financed expenditure in these areas did much to stimulate demand and drive production and GDP growth. What the experience in the automobile sector is pointing to is that the confidence required to keep this process going is waning. The passenger car industry may just be the first casualty. The next could be the housing market, where already there are signs of rising defaults, with the Reserve Bank of India has been warning banks of excessive increases in exposure. If that happens the reduction of GDP growth to 5 per cent could be just the beginning of a prolonged slide.

A feature of growth and accumulation under a neoliberal regime is that they ride on bubbles, driven in large measure by excess credit in the system. In India, as in many other emerging market economies, the liquidity needed to drive incremental bank lending was ensured by large inflows of foreign capital into the economy. But liquidity infusion alone is not enough. An environment that induces excess lending and borrowing must prevail as it did in India during the high growth years after 2003. Recent developments in the passenger car market suggest that this is not true anymore, leading to a growth slowdown. Since growth seems to be the main achievement that UPA II had to show for itself, it could be left searching for another bubble at the very end of its tenure.

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