

Slight brakes on manufacturing and automotive sector due to demonetisation in India

The recent move of demonetisation by the government has adversely affected the automotive industry. The initial spurt in sales on account of the hike in income due to Seventh Pay Commission, subsequent good monsoon and rise in demand in urban and rural areas of the country, has now subdued due to the shortage of legal tender. There has been a decline in sales of cars and two wheelers across the country.

However, automotive industry companies are living by the motto - "When the going gets tough, the tough gets going." Companies are preparing for a bigger reform in coming quarters.

The immediate impact

The immediate ripple effect of demonetisation on the automotive industry was a dip in the BSE Auto Index by 2.5 percent reported on 10 December, 2016. Companies slashed production and worked towards having "no-production days" to strike a balance with the slowdown and uncertainty over cash crunch in the market.

As per the Federation of Automobile Dealers Associations (FADA), which represents more than 11,000 automobile dealers, accounting for more than 90 percent of automotive retail trade and services industry in India, the entire auto retail trade has come under severe stress. Vehicle manufacturers have urged to reduce inventory at dealerships which are saddled with stock.

Fresh purchase decisions are also postponed due to the disrupted status quo. Car companies recently announced steep discounts in the range of 10-20% in December 2016. This was primarily done to clear the inventory of 15-30 days owing to the weak demand.

BSE Auto Index down by 2.5 percent on December 10, 2016.

The India's Purchasing Managers' Index (PMI) for November 2016 has shown a decline by 2.1 points.

Sale for cars without waiting period is down 30-50%.

Overall, month on month 25 % fall in the sales is witnessed.

Demonetisation has impacted the sales of vehicles in the second hand market for original equipment manufacturers (OEMs).

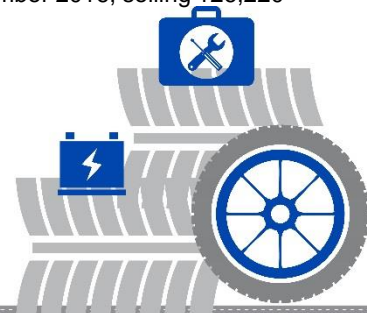
The current state

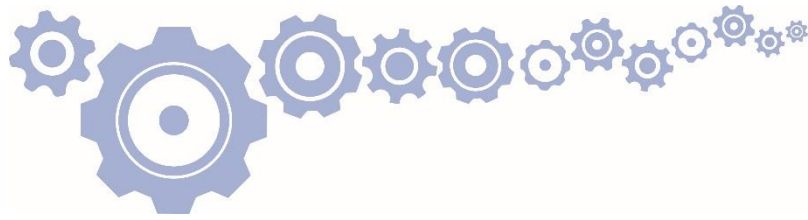
Post demonetisation there was some cushion at the wholesale level for certain auto companies from dealer demand for new models or new variants. At the retail level, sales for cars without waiting period is down 30-50% and 60-65% for entry level motorcycle. On the contrary, car makers who have pending orders managed to increase wholesale volumes. Manufacturers across segments have registered negative sales month-on-month basis comparing October and November 2016.

As per data released by Society of Indian Automobiles Manufactures (SIAM), the volume of total sales fell from 2,209,298 in October 2016 to 1,563,665 units in the demonetisation month i.e. November 2016. Thus, overall, as per the industry analysis, month-on-month 25% fall in the sales has been witnessed.

The exception

Beating the shock, country's largest car maker reported a 14.2% growth in domestic sales in November 2016, selling 126,220 units.





Views on segments and markets

Two-wheeler segment

The two-wheeler segment, which has dominated production volumes with the market share of about 78.6 percent of the total automotive production in the country in FY 2016 so far, recorded sales of 1.42 mn units (including exports) during the month of October 2016. However, the segment has been hit harder along with commercial vehicle segment. The later has also shown a decline of approximately 31 percent within the month of October to November 2016.

Tier-I vs tier-II cities

Although tier-I cities still have comparably better sales due to a number of prospects of purchasing cars through vehicle finance, rural areas and tier-II cities are the worst hit.

Here, most transactions take place through cash as availability and usage of plastic money is limited in these areas. Supply chains are thus hit as cash fuels many transactions. Although industry experts are calling this a temporary slump, new car sales for November 2016 have dropped by up to 20-30 per cent, whereas, sales of vehicles in the second hand market for original equipment manufacturers (OEMs) witness a strong impact.

Buyers are also unable to dispose off their old vehicles easily.

Accessories segment

The accessories segment has also felt the heat of demonetisation as it runs majorly on cash. After-sales market for components is down by 60-70% in northern India. Though one of the largest sources of revenue for the auto industry is generated by the selling of automobiles, the sale of auto parts actually carries a higher profit margin. An indicator of the economic health of the manufacturing sector, India's Purchasing Managers' Index (PMI) for November 2016 has shown a decline by 2.1 points to 52.30 being an overall decrease by 3.9 percent from the previous month, which however, still indicates some stability in the manufacturing sector.

Car rental business sees an upswing

As a result, an upward trend among people has been seen as they opt for rental cars instead of going for new ones. This is creating a positive impact of demonetisation on the car rental companies in India. In a big market for both new cars as well

as rentals, now it seems better to rent comparatively.

Overall, it is also expected that the sudden decline in money supply would lead to lowering of GDP growth. However, it may not be significant as some of the demand has only deferred and might re-enter the stream once the cash situation becomes normal.

Government of India heavily promotes foreign investment in the automobile industry by allowing 100 per cent FDI, under automatic route. The industry is de-licensed and allows free import of automotive components. As per Department of Industrial Policy and Promotion (DIPP), FDI inflow was 2.53 US\$ bn in automobile industry, which accounted for 6.3 per cent of total FDI equity inflow in the country in FY16.

The government is aiming to develop India as a global manufacturing and a research and development (R&D) hub. National Automotive Testing and R&D Infrastructure Project (NATRiP) centres as well as a National Automotive Board has been set up to act as a facilitator between the government and the industry.

The government plans to encourage use of eco-friendly automobiles such as hybrid vehicles, electrical vehicles and CNG based vehicles in India. Automotive Mission Plan (AMP) 2026 targets a fourfold growth in the automobiles sector in India which includes the manufacturers of automobiles, auto components and tractor industry over the next ten years. Implementation of Faster Adoption & Manufacturing of Electric Hybrid Vehicles (FAME) till 2020 would cover all vehicle segments, all forms of hybrid and pure electric vehicles.

Though, the current situation is negative but not yet bleak. Car makers across the industry are rolling out promotional offers and building awareness around use of online and digital modes to facilitate cashless transactions along with new offers and innovative schemes on vehicle. But an upswing in consumer sentiment is the key to avoid deep negative impact. It is expected that the new year will bring in some financial firmness and stability.