Challenges for automotive finance companies in 2H2013

Analyst: Hendro Utomo

With the recent increase in the price of subsidized fuel and Bank Indonesia consequently increasing its reference rate (BI rate), PEFINDO believes that the second half of 2013 (2H2013) will pose greater challenges for automotive finance companies.

The fuel price hike could lower purchasing power, which would weaken consumer demand and put more pressure on the asset quality of finance companies. PEFINDO believes that due to its nature, the motorcycle financing sector will be more affected by these policies than car financing players. However, the magnitude of this downturn is likely to be limited and temporary in nature. Supported by the continuously high need for means of transportation and in line with better risk management practices, we expect that the business and credit risk profile of finance companies will recover over the medium term.

A rosy start in 1H2013

Car financing companies enjoyed a relatively good start this year. In the first semester, new car sales exceeded 600,000 units, beating the 535,000 units sold in 1H2012 and 581,000 units in 2H2012. The first half's sales were driven mainly by continuous improvements in the country's macroeconomic condition, a stable interest rate environment and strong liquidity in the financial sector. A stronger purchasing power along with the continued lack of decent public transportation meant people opted for more convenient vehicles.

Meanwhile, motorcycle financing companies had a relatively stagnant first half. The industry has not yet fully recovered from the impact of down payment regulation issued in mid-2012, which led to new motorcycle sales in 2H2012 declining to less than 3.4 million units from 3.7 million units in 1H2012. Although the figure improved slightly to 3.9 million units in 1H2013, it was still below the 4.0 million achieved in each of the two semesters in 2011.

Motorcycle buyers are dominated by low- to middle-income segment consumers with limited disposable income. To attract this market, motorcycle finance companies used to allow down payments of 10% or even less. The new regulation, which requires a minimum down payment of 20%, therefore substantially reduced the number of potential buyers from this segment, especially considering that more than 80% of motorcycle sales are done by credit.

On the other hand, car buyers mainly come from the middle- to high-income classes, which are less sensitive to the changes in the down payment rule. Car finance companies had already been requiring relatively high down payments of around 20%. Thus, increasing the minimum down payment to 25% to 30% had a limited impact on the demand for new cars.

Challenges ahead

Despite the positive figures in 1H2013, PEFINDO believes that automotive finance companies will face tougher challenges in 2H2013 because of the subsidized fuel price hike by IDR 1,000 – IDR 2,000 per liter starting June 2013 and the increase in BI rate from 5.75% to 6.5%.

These policies will have a significant impact not only on the automotive financing industry but on several sectors. The higher fuel price has triggered an increase in the prices of basic goods and services, weakening purchasing power. This may reduce demand for automotive products as people may postpone their purchases to prioritize spending for basic necessities. PEFINDO is of the view that this, along with the cyclical slow sales period during the holiday season in August and December, would reduce demand for automotive products in 2H2013.

Motorcycle finance companies, whose customers mainly come from the more price sensitive low- to middle-income segments, will be more vulnerable to this recent economic development. The impact will be compounded by the implementation of the minimum down payment for sharia financing in April 2013. As a result, demand for new motorcycles may continue to weaken in 2H2013, and PEFINDO believes that overall motorcycle sales for 2013 may come out slightly lower than last year's. This situation may affect the business profile of motorcycle financing companies.

Moreover, due to weaker purchasing power among consumers, PEFINDO believes it is possible for motorcycle financing companies' non-performing receivables to increase. The risk, however, would be partially mitigated by the implementation of the higher down payment rule. Overall, PEFINDO believes that the overall credit risk profile of motorcycle finance companies will remain under pressure as a result of the potentially weaker demand in the second half of the year and the possibility that its asset quality profile would worsen.

Car sales will be less affected by all this, as PEFINDO believes that car buyers are more resistant to the economic downturn. With the wide variety in the prices of car products, cheaper alternatives exist for consumers. Any decrease in car sales would also be partially mitigated by the expected launch of low-cost green cars (LCGC) in 4Q2013. LCGC has a substantial tax benefit and are expected to be in high demand among potential car buyers.

Under these circumstances, PEFINDO expects car sales in 2H2013 to only be slightly lower than in 1H2013, making the full-year sales figure stagnant when compared to FY2012. With the high down payment requirement implemented by car finance companies and their better consumer risk profile, PEFINDO also believes that the car finance companies' asset quality profile will remain sound. Therefore, we believe that the overall credit profile of car finance companies is relatively stable in the medium term.